2020 Tax Law Update

Stacey A. Prince-Troutman

3.10.2020

akerman

Recent Developments

- **Transfer Tax Exemption Amounts**
  - Estate, gift, and GST tax exemption amount (indexed for inflation) is $11.58 million
  - Gift tax annual exclusion amount remains at $15,000
- **Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act")**
  - Signed into law on December 20, 2019

KEY 2019 SECURE ACT AND TAX EXTENDERS

NEW IRA RULES	401(K) PROVISIONS	OTHER PROVISIONS	TAX EXTENDERS
• Elimination of the lifetime "stretch" provision for non-spouse beneficiaries of inherited IRA and other retirement accounts, replaced by a 10-year distribution cap • RMDs for IRAs required to start beginning at age 72 (instead of 70 ½) • Removal of 70 ½ contribution age limit • $5,000 Qualified Birth or Adoption Distribution • Taxable non-tuition fellowship and stipend payments treated as compensation for IRA purposes • Non-deductible IRA contributions can be made with certain foster care payments	• Provision of ERISA fiduciary Safe Harbor for selecting an annuity provider for retirement plans. • Creation of a "distributable event" for annuities no longer allowed as plan invstment options • Tax credit for small businesses that establish a 401(k) (or a 403(b), SEP IRA, or SIMPLE IRA) • Tax credit for adoption of auto-enrollment of participants in 401(k) plans • Maximum contribution for 401(k) automatic enrollment increased to 15% • Long-term. part-time employees who work at least 500 hours in at least three consecutive years will be eligible to participate in their employer's 401K plan • Provides for MEPs to maintain qualified status overall, if only one employer's portion is disqualified • Elimination of 401(k) loans made via credit cards or similar arrangements	• Employers may adopt employer-funded retirement plans up to the due date of the employer's tax return • Increased penalties for employers failing to file taxpayer and employee benefit plan returns • Qualified education expenses for 529 plan funds expanded for student loans and apprenticeships • Kidde tax reverts applicable children's income to be subject to child's parents' marginal tax rate • Allowance of qualified Disaster Distributions up to $100,000 per disaster, from retirement accounts	• Discharge of certain qualified principal residence indebtedness is excluded from gross income • Allowance of mortgage insurance premium deduction • Deduction for qualified tuition and related expenses • AGI 'hurdle rate' for deducting qualified medical expenses to remain at 7.5% • Miscellaneous incentives for economic growth, energy production, and green initiatives

Tax Law Changes

- Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act")
  - Changes to Required Beginning Date Rules
    - The new required beginning date for an IRA owner is April 1 of the calendar year following the calendar year in which the individual attains age 72; formerly, it was April 1 of the calendar year following the calendar year in which the individual attains age 70 ½.
    - New rule is effective for distributions required to be made **after** December 31, 2019, with respect to individuals who will attain age 70 ½ after that date.
    - The SECURE Act did not change the required beginning date for IRA owners who attained age 70 ½ prior to January 1, 2020.

Tax Law Changes

- SECURE Act
  - Changes to Required Beginning Date Rules
    - **Example:** John was born June 30, 1949. He reaches age 70 ½ on December 30, 2019. Because he turned 70 ½ before 2020, he is still governed by the old rule. The required beginning date for his IRA is still April 1, 2020.
    - Jane was born a day after John, on July 1, 1949. She will reach age 70 ½ a day later too, on January 1, 2020—so she is governed by the new rule. Her required beginning date will not be until April 1 of 2022, the year after the year (2021) in which she turns age 72.

Tax Law Changes

- Setting Every Community Up for Retirement Enhancement Act of 2019 (“SECURE Act”)
  - Repeal of Age Limit for IRA contributions
    - Repeals prohibition on deductions for contributions to traditional IRA’s in and after the year an individual attains the age of 70 ½
    - Traditional IRA’s were only type of retirement plan to have an age cap
    - Now anyone with “earned income” can continue to make contributions to a traditional IRA; limited to amount of “earned income”
    - “Earned income” is income subject to payroll taxes
    - For 2020, the maximum IRA contribution amount is **$6,000 per person**, with **$1,000 catch up** contribution for anyone age 50 or older
  - Revision to “Stretch” Distribution Period for Inherited IRAs and other retirement accounts

SECURE Act

Summary

- New Section 401(a)(9) added to the Code
  - Section 401(a)(9)(H) provides for new payout periods applicable to all designated beneficiaries
  - 10-year payout replaces the life expectancy payout ***unless*** certain exceptions apply
  - Eligible designated beneficiaries are entitled to a modified version of life expectancy payout

SECURE Act

Familiar Concepts

- **Designated Beneficiary**
  - Individual
  - See-through trust named as beneficiary
    - Conduit Trust:
      - All distributions (after deduction of applicable expenses) made from the retirement plan to the trust during the lifetime of the "conduit" beneficiary of the trust must be distributed to passed out to the individual life beneficiary.
      - The conduit beneficiary is considered the sole beneficiary of that trust and of the plan for RMD purposes, regardless of who will inherit the trust and remaining plan benefits if the conduit beneficiary dies prior to complete distribution of the retirement plan.
      - A conduit trust "automatically" qualifies as a see-through trust. *See* Treas. Reg. Section 1.401(a)(9)-5, A-7(c)(3), Example 2.

SECURE Act

Familiar Concepts

- See-through trust named as beneficiary, ***Cont.***
  - Accumulation Trust: the trustee can "accumulate" retirement plan distributions in the trust during the lifetime of the initial beneficiary(ies) for possible later distribution to another beneficiary. With certain exceptions, all beneficiaries who might ever be entitled to receive such accumulations are "counted" as beneficiaries for purposes of applying the minimum distribution.
  - An accumulation trust qualifies as a see-through trust only if all of the countable beneficiaries are identifiable individuals. *See* Treas. Reg. Section 1.401(a)(9)-5, A-7(c)(1).
  - If any "countable" beneficiary of an accumulation trust is not an individual, the trust does not qualify as a see-through.
- **Non-Designated Beneficiaries**
  - Participant's estate, a charity, or a trust that is not a see-through trust

SECURE Act

Familiar Concepts

- **Applicable Distribution Period: Old Law**
  - If the designated beneficiary is an ***individual***, then the payout period would be either: (a) beneficiary's life expectancy, or (b) payout under the non-designated beneficiary rules if more favorable
  - If the designated beneficiary is a ***see-through trust*** named, then the payout would be either: (a) the life expectancy of the oldest trust beneficiary, or (b) payout under the non-designated beneficiary rules if more favorable
  - If the beneficiary is a non-designated beneficiary, then the payout period would be:
    - **5 years**, if the participant died before his or her required beginning date for commencement of lifetime distributions ("**RBD**")
    - **Participant's remaining life expectancy**, if participant died on or after his or her RBD

SECURE Act

Familiar Concepts

- **Applicable Distribution Period**
  - If a designated beneficiary died before the end of his life expectancy payout period, the next beneficiary in line (whether or not qualifying as a "designated beneficiary") stepped into the decedent's shoes and could withdraw over the remaining life expectancy of the original designated beneficiary.
  - Special Rules:
    - Surviving spouse: unique option of "rolling over" the inherited benefits to his/her own retirement plan
    - Rearranging/changing beneficiaries post participants death to optimize "required minimum distribution" ("**RMD**") treatment

SECURE Act

New Law

- Non-Designated Beneficiary
- Designated Beneficiary <u>other than</u> "eligible designated beneficiary"
  - Payout is 10 years
- Designated Beneficiary <u>who is an</u> "eligible designated beneficiary"
  - The surviving spouse of the participant. *See* Section 401(a)(9)(E)(ii)(I). The surviving spouse can still use the life expectancy payout. However on such spouse's death, the exception ceases to apply and a 10-year payout applies.
  - Minor child of the participant. *See* Section 401(a)(9)(E)(ii)(II). The life expectancy payout applies to a "child of the employee who has not reached majority (within the meaning of subparagraph (F)." However, upon reaching majority, the 10-year rule applies.
  - Disabled beneficiary. The life expectancy payout applies to a designated beneficiary who is disabled (within the meaning of Section 72(m)(7). Upon death of the designated beneficiary, the 10-year payout rule applies.

SECURE Act

New Law

- **Designated Beneficiary who is an "eligible designated beneficiary", *Cont.***
  - Chronically ill individual. The life expectancy payout applies to a designated beneficiary who is chronically ill (within the meaning of Section 7702B(c)(2)). Upon such beneficiary's death, the 10-year payout rule applies.
  - Beneficiary less than 10 years younger than participant. The life expectancy payout applies to an individual who is not more than 10 years younger than the participant; upon such beneficiary's death, the 10 payout rule applies.

SECURE Act

New Law

- **Impact on Trusts.**
  - Conduit Trusts:
    - Assumes a single individual beneficiary ("conduit beneficiary") receives benefits under the trust.
    - Individual treated as the participant's sole designated beneficiary
    - Result the same as leaving the benefits outright to that individual
    - If the individual **is not** an **eligible designated beneficiary**
      - The trust will be subject to the 10-year payout rule. The conduit beneficiary will receive outright distribution of 100% of the retirement benefits within 10 years after the participant's death (because the conduit provision requires the trustee to pass all retirement plan distributions out to the conduit beneficiary more or less immediately upon receipt).

SECURE Act

New Law

- **Impact on Trusts.**
  - Conduit Trusts, ***Cont.***:
    - If the individual **is** an **eligible designated beneficiary**
      - The trust will be entitled to the "life expectancy payout" exactly as such individual would be entitled if named directly as beneficiary.
  - Accumulation Trusts
    - Since the life expectancy payout is no longer an option for accumulation trusts, it no longer matters who is the "oldest beneficiary" of the trust.
    - *Uncertain Results – New Regulations to Clarify*
      - An accumulation trust cannot qualify for eligible designated beneficiary treatment, **even if the primary or life beneficiary of the trust is an eligible designated beneficiary**. This conclusion is based on the fact that the eligible designated beneficiary is not the sole beneficiary of the participant.

SECURE Act

New Law

- **10-Year Payout Rule:**
  - All amounts must be distributed by December 31 of the year that contains the 10th anniversary of the date of death. *See* Treas. Reg. Section *1.401(a)(9)-3, A-2*
  - Unlike with the life expectancy payout, there is no requirement of annual distributions. The distributions can be made at any time or times during the 10-year period as long as the plan is totally distributed by the end of the period. *See* Treas. Reg. Section *1.401(a)(9)-3, A-2*
  - The rule applies whether the participant died before or after his or her required beginning date for commencement of lifetime distributions. *See* Section 401(a)(9)(H)

SECURE Act

New Law

- **10-Year Payout Rule:**
  - **Example**: On January 21, 2020, Josh's father passed away, leaving Josh his $400,000 IRA. Josh, who is currently age 60, is still working and earns roughly $150,000 per year, but plans to retire in 5 years, at age 65.
  - Given the fact that Josh's income will substantially decrease when he retires, it may make sense for him to avoid taking any distributions from the inherited IRA while he is still working (i.e., during the first 5 years of the distribution window provided by the 10-Year Rule). Instead, he can opt to distribute the funds during years 6-10, when he expects his income to be much lower after his wages are gone (and before he begins Social Security benefits).

SECURE Act

Planning After the Act

- **Surviving Spouse:**
  - Benefits left outright or in conduit trust for benefit of spouse
    - The conduit trust does not have to commence taking required beginning date distributions until the end of the year in which the deceased participant would have reached age 72. *See* Section 401(a)(9)(B)(iv)(I).
    - The spouse's life expectancy, recalculated annually, will be the Applicable Distribution Period.
    - The 10-year rule will not apply during the spouse's life.
  - Benefits left in a see-through accumulation trust for benefit of spouse
    - *Uncertain Results – New Regulations to Clarify*
      - Not eligible for the life expectancy payout, even if the spouse is sole life beneficiary
      - If so, the trust is subject to the 10-year payout rule

SECURE Act

Planning After the Act

- **Minor Child of the Participant:**
  - Benefits left outright or in conduit trust for benefit of minor child
    - Life expectancy payout as the child is considered the "sole designated beneficiary"
    - Entitlement **<u>only lasts</u>** until he/she attains majority.
    - Upon child attaining majority, the 10-year payout rule applies. *See* Section 401(a)(9)(E)(iii).
    - Note:
      - This exception only applies to the child of the participant
      - Ceases to apply once the child reaches majority (within the meaning of subparagraph Section 401(a)(9)(F).
      - Presumably the child reaches majority when he or she attains the age of majority applicable in his or her state of residency (typically 18 or 21).

SECURE Act

Planning After the Act

- **Minor Child of the Participant:**
  - Benefits left to an accumulation trust for benefit of minor child
    - An accumulation trust for the child enables the parents, through their chosen trustee, to control the funds for a longer time, until the child reaches a more mature age.
    - The trust would not be an eligible designated beneficiary because the minor child is not considered the sole beneficiary of an accumulation trust, even if he/she is the sole lifetime beneficiary. *See* Treas. Reg. Section 1.401(a)(9)-5, A-7(c)(1).
    - 10-year payout rule applies.

akerman

SECURE Act

Planning After the Act

- Minor Child of the Participant:
  - **Example**: Jed is a 40-year-old IRA owner with a 5-year-old daughter. The age of majority in the state where Jed and his daughter live is 21. Sadly, Jed dies is an auto accident, and leaves his IRA to his daughter.
  - His daughter will have to take ‘regular’ lifetime RMDs, beginning the year after she inherits, until she reaches age 21. Once she turns 21, the 10-year rule will apply, requiring the entire inherited IRA to be fully depleted over the next decade (i.e., by the end of the year in which she turns 31).

SECURE Act

Planning After the Act

- **Disabled or Chronically Ill Beneficiary:**
  - Disabled Beneficiary:
    - "Disabled (within the meaning of section 72(m)(7))" is an eligible designated beneficiary. *See* Section 401(a)(9)(E)((ii)(III).
    - Section 72(m)(7) provides that:
      - "an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration."
      - An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require.
      - Entitlement to Social Security disability benefits may established status as disabled under Section 72(m)(7).

SECURE Act

Planning After the Act

- **Disabled or Chronically Ill Beneficiary:**
  - **Chronically Ill Beneficiary**:
    - A designated beneficiary who is "a chronically ill individual (within the meaning of Section 7702(B)(c)(2)" is an eligible designated beneficiary. *See* 401(a)(9)(E)((ii)(IV).
    - A chronically ill beneficiary is defined pursuant to Internal Revenue Code Section 7702B(c)(2), and is an individual that (i) is unable to perform (without substantial assistance from another individual) at least two activities of daily living for a period of at least 90 days due to a loss of functional capacity; **or** (ii) requires substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment.

SECURE Act

Planning After the Act

- Disabled or Chronically Ill Beneficiary:
  - Note:
    - Status as disabled or chronically ill determined as of the date of the participant’s death.
    - Trusts for disabled and/or chronically ill eligible designated beneficiaries are given two special breaks not granted to trusts for surviving spouses, minor children, and less-than-10-years-younger beneficiaries. These breaks apply to “applicable multi beneficiary trusts”.

SECURE Act

Planning After the Act

- **Disabled or Chronically Ill Beneficiary:**
  - **Note**, Cont.:
    - In Section 401(a)(9)(H)(v), the term "**applicable multi-beneficiary trust**" means a trust:
      - That has more than one beneficiary
      - All of the beneficiaries treated as designated beneficiaries for purposes of determining the distribution period, and
      - At least one of the beneficiaries is an eligible designated beneficiary who is disabled or chronically ill

SECURE Act

Planning After the Act

- **Disabled or Chronically Ill Beneficiary:**
  - **Note**, Cont.:
    - If under the terms of the **applicable multi-beneficiary trust:**
      - Upon the employee's death, the trust must immediately divide into separate trusts for each beneficiary, the payout rules shall be applied separately with respect to the portion of the employee's interest that is payable to any disabled or chronically ill eligible designated beneficiary. *See* Section 401(a)(9)(H)(iv)(I), (v).

SECURE Act

Planning After the Act

- **Disabled or Chronically Ill Beneficiary:**
  - **Note**, Cont.:
    - If under the terms of the **applicable multi-beneficiary trust:**
      - If under the terms of the trust, only eligible designated beneficiaries [EBD] who are disabled or chronically ill individuals have right to the employee's interest in the plan, then the life expectancy exception "shall apply to the distribution of the employee's interest and any beneficiary who is not such an [EDB] shall be treated as a beneficiary of the [EDB] upon the death of such" EDB. *See* Section 401(a)(9)(H)(iv)(II), (v).
        - It appears that an accumulation trust for a disabled beneficiary, could get the life expectancy payout treatment, even though (under the regulations) the disabled beneficiary is not considered the sole trust beneficiary.

SECURE Act

Planning After the Act

- **Less-than-10-years-younger Beneficiary:**
  - An individual who is not a surviving spouse, minor child, disabled or chronically ill individual and who is not more than 10 years younger than the employee is an eligible designated beneficiary and is entitled to a life expectancy payout
  - ***Example:*** Participant never married. Now age 75, she wishes to leave her $3 million IRA to her three siblings, all of whom are older than age 65. Each sibling, as an EDB, will be able to withdraw his or her share of the inherited IRA over his or her life expectancy (assuming they divide the inherited IRA into separate accounts by 12/31 of the year after the year of Patty's death).

SECURE Act

Effective Date

- New Section 401(a)(9) added to the Code
  - Generally, SECURE's amendments to the post-death minimum distribution rules "shall apply to distributions with respect to employees who die after December 31, 2019"
  - If an employee dies before the effective date [i.e., before 2020](the "grandfathered participant") then, in applying the amendments made by this section to such participant's *designated beneficiary who dies after such date*—
    - The amendments will apply to any beneficiary of such designated beneficiary; and
    - Such *designated beneficiary* shall be treated as an eligible designated beneficiary for purposes of applying section 401(a)(9)(H)(ii)

SECURE Act

Effective Date

- Exceptions
  - Plans maintained pursuant to a collective bargaining agreement have an effective of January 1, 2022 (unless the collectively bargained agreement terminates sooner).
  - Governmental plans, such as 403(b) and 457 plans sponsored by state and local governments, and the Thrift Savings Plan sponsored by the Federal government (and in which Congresspersons, themselves, participate) are not impacted until January 1, 2022.
  - Annuities in which individuals have already irrevocably annuitized over a life or joint life expectancy, or in which an individual has elected an irrevocable income option that will begin at a later point, are exempt entirely (and simply follow the already-binding contractual provisions of the annuitized contract).

SECURE Act

Impact on Pre-2020 Deaths

- Examples
  - **Single Designated Beneficiary Example (Outright)**: Gloria died in 2012, leaving her IRA to her son Alfred as sole designated beneficiary. Since then, Alfred has been taking annual minimum required distributions from the inherited IRA computed based on his 34.2-year life expectancy. Alfred names his son Carl as successor beneficiary to the account in case Alfred dies in less than 34.2 years. Alfred dies in 2020, when there are still over 20 years left in his original "life expectancy".
    - Applicable Distribution Period
      - Pre-SECURE Act, grandson Carl would step into the shoes of the deceased designated beneficiary Alfred and take distributions over the remaining 26 years of Alfred's life expectancy.
      - Under the SECURE Act, grandson Carl is subject, instead, to the 10-year rule. He will have to withdraw the entire remaining balance of this inherited IRA by December 31, 2030.

SECURE Act

Impact on Pre-2020 Deaths

- Examples
  - **Single Designated Beneficiary Example (Conduit Trust)**: Phyllis died in 2012, leaving her IRA to a conduit trust for the sole life benefit of her son Todd. Since then, the trustee of the conduit trust has been taking annual minimum required distributions from the inherited IRA computed based on Todd's 34.2-year life expectancy (and additional distributions in the trustee's discretion) and passing out all such distributions (required or discretionary) (after payment of applicable fees and expenses) to Todd (or for his benefit).
  - Phyllis's trust provides that if Todd dies when there is still money left in the IRA, the trust ceases to be a conduit trust, and instead continues as a "family pot" trust for the benefit of Phyllis's five grandchildren.
  - The Trustee is to hold all trust funds, including IRA distributions, in trust, using the income and principal of the trust as the trustee deems advisable for the health, education, and support of such grandchildren until the youngest grandchild reaches age 35 at which time all remaining trust assets are passed out to the surviving grandchild(ren).

SECURE Act

Impact on Pre-2020 Deaths

- Examples
  - **Single Designated Beneficiary Example (Conduit Trust), Cont.**:
  - Todd dies in 2020, when there are still over 25 years left in his original life expectancy.
  - Applicable Distribution Period
    - Pre-SECURE Act, the trustee could withdraw the remaining IRA assets gradually over what was left of Todd's life expectancy, then distribute them to or for the benefit of the grandchildren either immediately or in a later year.
    - Under SECURE Act, the trustee must withdraw the entire remaining balance of this inherited IRA by December 31, 2030. He will then administer the remaining funds (after payment of tax on the IRA distributions, to the extent such distributions are not passed out to the trust beneficiaries as DNI) for the benefit of the grandchildren as provided in the trust instrument.

SECURE Act

Planning Opportunities

- Disclaimers
  - **Example**: Dad died in November 2019, leaving his $1 million IRA to Mom as primary beneficiary with their three nondisabled adult children as contingent beneficiaries. If Mom accepts the IRA, rolls it over to her own IRA, and dies after 2019 leaving it to the children [the typically recommended scenario pre-SECURE], the best payout period the children will get is 10 years. If she doesn't need the money, she could consider disclaiming the IRA and allowing it to pass to the children as Dad's contingent beneficiaries. As beneficiaries of a pre-2020 decedent, the children would be entitled to a life expectancy payout.

SECURE Act

Call to Action

- Review beneficiary designations
- Review estate planning documents
- Discuss modification of irrevocable trusts
- Discuss use of disclaimer
- Discuss tax consequences of payout given elections
- Consider charitable trusts

Questions & Answers

Stacey Prince-Troutman

stacey.prince-troutman@akerman.com

(407) 419-8553

Akerman LLP
700+ Lawyers
25 Offices

akerman.com

akerman