The Changing Landscape of IRA Planning

Strategies for Maximizing Post-Death Control While Minimizing Taxes

When dealing with the responsibility of working with clients for their IRA planning, the landscape has changed due to the passing of the Secure Act 2.0 on December 23rd, 2022. The changes brought about by this and the previous Secure Act 1.0 have implications for the tools and strategies that we can help clients employ for their estate planning goals. Our discussion today is about the changes that occurred, the options that still exist, and the downside of not properly planning for what happens to IRA money when someone passes away.

An IRA is an interesting asset because at its core, it is built on practical, prudent planning, and delayed gratification. It's the ultimate gift to your future self and your family. You spend a lifetime forgoing fun lifestyle purchases, extra trips, a nicer home, or a better car just to name a few in exchange for saving for the distant future. Over half of IRAs in the US are created prior to age 50, meaning that people are, at minimum, delaying the use of the money in them for 10 years, and in some instances, even longer than 30 years.

There is always some tax trade-off associated with any IRA contribution. For a traditional IRA, you are trading off paying taxes later in life for getting the deduction today. In some IRA or qualified plans, this can actually be a primary motivator for doing the planning at all. With a Roth IRA, you pay the taxes now, once and for all, in exchange for tax-free growth throughout your lifetime. The majority of our discussion today is based on traditional IRAs, but it is important to note that within the Secure 2.0 Act, RMDs (Required Minimum Distributions) on Roth IRAs were eliminated.

So, you have this asset that you carefully and methodically accumulated for decades while you were gainfully employed and didn't need the money. Then, all of a sudden, you retire, and without proper planning, the tendency is to just raid the asset and live off of it in retirement. The consequences of not planning how to distribute the IRA assets could have significant impacts to what you are to spend during your lifetime and leave to your family. What was once created for hope and tax savings can sometimes become a tax burden that you have to manage for the rest of your life. It does not have to be that way. There are strategies and tools that still exist to help ensure that whatever is left in your client's IRA goes to the people or causes that mean the most to them in the world, rather than being spread among 320 million people evenly by just having to pay more taxes than necessary.

Before we discuss our current situation, we need to talk about where we were prior to the passage of the two Secure Acts. The power of a traditional IRA lies in the compounding growth of an asset unencumbered by taxes. As citizens, we enjoy this tax deferral during our lives, and until January 1st, 2020, when the Secure Act was passed, we could pass this deferral along to our beneficiaries. A spouse of an IRA participant can still rollover IRA funds into their own IRA upon the participant's death. This aspect remains unchanged in the new legislation.

However, when leaving the IRA to a non-spouse beneficiary, the popular planning strategy employed prior to the Secure Act was to use a stretch IRA plan. The stretch IRA provision allowed the beneficiary to take only the required minimum distributions based on their age, while keeping the majority of the assets in a tax-deferred status. This strategy facilitated legacy planning and allowed beneficiaries to defer the majority of income taxes on their inherited portion for decades. If the IRA was left to a trust instead of the beneficiary directly, the trust could utilize the same strategy. With the implementation of Secure Act 1.0 and continued with 2.0, the stretch IRA provision has been eliminated. Now, the IRA must be liquidated within 10 years of the participant's death. This change created a tax consequence for beneficiaries upon death.

What was taken away from the Stretch IRA was given back to current retirees though. Prior to 2019, required minimum distributions were mandated to begin at age 70.5. Secure Act 1.0 changed this to age 72, and Secure Act 2.0 pushed this further. Here are the new rules that were created:

- If the IRA participant turns age 73 prior to 2024, then the RMD must begin April 1st, 2023.
- If the IRA participant turns age 73 in 2024, then the RMD must begin April 1st, 2025
- If the IRA participant turns age 73 between 2025 and 2031, then they start they must begin RMD April 1st of the following year
- If the IRA participant turns age 74 in 2033, then they can defer RMD until April 1st, 2035
- If the IRA participant turns age 75 2035 or later, they can take RMD April 1st the following year.

Essentially, RMDs are pushed to around ages 73/74 for the foreseeable future, and under current law, clients who are 63 or younger can expect to defer RMDs until age 75. If an IRA can be seen as a long-term collateralized loan from the government, with taxes as the interest due, the government has essentially granted some loan forgiveness. If investments perform well, you can earn compound interest on the taxes that you were able to defer. Assuming the client maintains a similar investment strategy regardless of their investment status, the major unknown factor is tax rates and tax brackets.

There's an important distinction to make between the two types of IRA participants that exist. There are participants who will need the bulk or all of their IRA to sustain their retirement lifestyle, whom we'll refer to as "I'll use the money IRA clients". Then, there are clients with large IRA balances who likely won't need the IRA funds for retirement and want to minimize the impact of taxes on their beneficiaries. We'll call them inheritance focused clients. While there are some commonalities in planning for both types of clients, there are also differences. For IRA participants relying on the asset for their retirement, the goal is to minimize the impact of current taxes on their lifestyle. However, IRA participants focused on estate transfer must be mindful of current taxes while also considering the long-term effects of taxes on their beneficiaries. It's important to keep both types of IRA participants in mind when considering the following changes that occurred. Every change brings disruption, but it also creates opportunities. The Secure Acts removed certain opportunities but also created new ones. Let's explore the impact of these changes and how they create opportunities.

IRA catch up provision was increased

  - "I'll use the money" IRA client: This will allow additional current tax savings for IRA contributions, or additional Roth IRA contributions to be made over age 50. The catch up will now be indexed to inflation, so over time it could be a significant increase beyond the normal catch up allowed
  - Inheritance Focused clients: For clients in this estate planning space, they are likely ineligible for contributions due to earnings, but if available, they would want to take advantage of increased ROTH IRA contributions that will be available.

- Catch Up for Retirement Plan Participants: Participants in retirement plans that are ages 60-63 will have increased limits starting in 2025
  - Any increase to contributions impacts both types of participants positively, because it allows for current year tax savings in a traditional 401K, or additional lifetime tax free growth in a 401K IRA.
- 529 Rollover Change: Starting in January of 2024, if a 529 plan was in effect for 15 years, funds are allowed to be rolled over into a ROTH IRA in the child's name. Previously, any excess 529 funds were subject to taxes and peanlties, but this new provision allows for $35,000 rollover into Roth IRA.
  - Inheritance Focused clients: Additional ROTH IRA planning for their children can have a positive impact on their children's retirement planning, and could create incentive for additional 529 contributions to be made by them
- QCD Expansion: Qualified Charitable Distributions (QCD) will increase to $100,000 in 2024 and have an inflation adjustment
  - "I'll use the money" IRA client: If the client is currently making charitable donations, taking advantage of this provision within their current donations could create tax efficiency from distributions from the IRA
  - Inheritance Focused clients: The increases and inflation adjustment in this provision can expand some of the planning that is done already in the estate planning space for this type of participant.
- The age 50 expansion: Qualified Public Safety officers who are over 50 and meet the criteria outlined in the act are exempt from 10% penalty for early withdrawal. Many of these occupations have retirement prior to age 59.5, so this exemption creates the ability to do some of the planning prior to age 60, because you do not have to hurdle the 10% additional tax. There was also an additional exemption to the penalty created for victims of domestic abuse.
  - "I'll use the money" IRA client: This could open up spending down the IRA assets in early years of retirement to allow deferral of other classifications of assets.
  - Inheritance Focused clients: Distributions of IRA assets can be used to purchase life insurance, which is tax free at death, and can be estate tax free as well, while the client is younger and life insurance rates are lower.

Now that we've gone from where we were, and discussed the changes, there's still a lot to talk about in what has stayed the same. Tried and true IRA strategies still exist, and are listed below:

- Balancing taxes: Taxes will be due on your current income, your future growth, or at your death. The bad news is that you have to pay taxes either way, the good news is that you get to choose.
  - Traditional IRA allows you to save taxes now, and pay them later.
  - Roth IRA allows you to pay taxes now, but never again.
  - Life Insurance allows for after tax contributions to be leveraged for tax free benefits to your family or to be accessed tax free during the participants lifetime.
- Managing Your Income Tax Bracket: Once you've decided how you want to accumulate money (Tax Free, Tax Deferred); you still have a decision on when to pay the taxes. For a traditional IRA, clients will want to balance distributions from other types of asset classifications to minimize the impact of taxable distributions on their income tax each year
  - If a client has a make up of various assets with capital gain taxation, no taxes due (Cash, life insurance values or Roth IRA) and traditional IRA assets, any distributions should be viewed with their impact of current income taxes. For years in which income is high, deferrals of traditional IRA distributions can save taxes by waiting to distribute them when income is lower in other years.
- Integrating annuities within portfolio of assets: Various annuities exist that when combined with traditional IRA/Roth IRA assets can create tax efficiency.
  - Guaranteed Income Annuities can create stable income that smooths out distribution volatility on RMDS.
  - Qualified Longevity Annuity Contracts (QLACs) can allow for additional tax deferral.
  - Additional tax deferral on non-qualified assets, can allow for efficient spend down of IRA assets to minimize tax brackets.
- Charitable distributions: Now expanded by Secure Act 2.0; IRA participants who are charitably inclined can make efficient transfers from their IRA to benefit their causes, and also have a net positive impact on their current taxes and their legacy they leave to their family.
  - If you are charitably inclined and do not do proper planning, you leave more money than you planned to your default charity, the United States Treasury. Tax benefits exist for a reason to promote giving, and if you are already charitably inclined, you should maximize what is allowable.
- The Power of Life Insurance
  - Life insurance's tax benefits of tax deferral, tax free distributions and the tax free benefit at death allow for clients to create larger inheritances, have more control over the inheritance and potentially pay fewer taxes during their lifetime.
  - Life insurance is a natural consideration for clients with large traditional IRA balances. The IRA is subject to taxation at death, with maximum spread over 10 years. Life insurance proceeds pay out at death, so it's perfect timing, to have this tax free lump sum occur immediately when a tax is generated
  - Life insurance proceeds bypass probate and wills, and are payable directly to the stated beneficiary of your choosing. This could include a trust that can create control and protection for your family well beyond your lifetime.
  - Life insurance proceeds can be used an estate equalization tool. Many IRA participants were able to create their large balances in companies that they owned, and in many businesses, for owners with multiple children, not all of their children are involved in the business. Life insurance can help balance out the fairness of the inheritance to make the Thanksgivings after you're gone a lot more friendly.
  - Life Insurance cash values can be used to supplement retirement and help manage the IRA participants tax bracket. In low income years, distributions from the IRA can be taken to take advantage of low income tax bracket. For high income years, tax free life insurance distributions can help defer taxes from IRA until potentially lower tax bracket years
- Other IRA Spend Down to fund other planning strategies
  - Charitable Remainder Trusts
  - Life Insurance trusts with spousal lifetime access (SLAT)
  - Life Insurance trusts with beneficiary lifetime access (BLAT)

An IRA is easy to implement and has time to grow, but it is complex to manage. Its impact on taxes spans an entire lifetime, and at every step of that process, as advisors, we can help guide the participant to achieve their goals. Any tax efficiency has a direct impact on their spending during their lifetime and what they ultimately leave to their family or charitable causes. Life Brokerage specializes in the life insurance and annuity space, providing our advisors access to hundreds of products across dozens of different insurance companies that can maximize IRAs for your clients. Let us know how we can assist you in guiding your clients as they plan for retirement and beyond.

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