New Retirement Planning Law Goes into Effect

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On December 20, 2019, President Trump signed the *Setting Every Community Up For Retirement Enhancement Act (SECURE Act)* into law. The SECURE Act made many big changes to long-standing qualified retirement plan and individual retirement account (IRA) rules. Four key provisions of the SECURE Act affect estate and charitable planning with qualified retirement plans and IRAs:

1. Repeal of the maximum age for contributing to a regular IRA.
2. An anti-abuse rule that affects charitable giving through a qualified charitable distribution (QCD) from an IRA.
3. Extension of the age for having to begin required minimum distributions (RMD) from 70½ to 72.
4. Elimination of the lifetime stretch of receiving IRA benefits for most non-spouse IRA beneficiaries.

Repeal of Maximum Age for Making a Tax-Deductible Contribution to an IRA. One provision repealed the maximum age for making tax-deductible IRA contributions. Under **prior law**, someone who was over the age of 70½ **couldn't** make a tax-deductible contribution to a regular tax-deferred IRA. The SECURE Act repealed that age limit.

Under the SECURE Act, IRA account holders **of any age** are now allowed to make deductible contributions to their regular IRAs. It's important to remember that the IRA account holder must have **compensation**, generally earned income, e.g., wages, etc., from which to contribute to the IRA, as **passive income**, e.g., many rents, all dividends, interest, etc., **doesn't count**.

Warning: A QCD Trap for Some. In light of repeal of the age limit on making tax-deductible contributions to an IRA, people immediately thought about making a tax-deductible contribution to an IRA **and** causing a qualified charitable distribution (QCD) to be made out of the IRA in the same year, thereby giving the effect of a fully tax-deductible charitable contribution. Recall that one doesn't normally get an income tax charitable contribution deduction for making a QCD. However, a QCD eliminates the income tax on the QCD (up to $100,000 per taxpayer per year – the SECURE Act didn't change that either) and counts toward one's RMD.

At first glance it looks like combining a tax-deductible charitable contribution to an IRA with a QCD would give the taxpayer the best of all possible worlds – avoidance of the income tax on the QCD, an above-the-line income tax deduction for a contribution to an IRA, and satisfaction of the RMD. However, all that glitters about the SECURE Act is not golden.

Unfortunately, the SECURE Act **quashes** that possibility. This is because another provision effectively requires a **last-in-first-out** (LIFO) accounting principle to apply to IRA contributions. This means that the QCD would carry out taxable income **first** from the post age 70½ IRA contribution made **last**, up to the amount of the tax-deductible contribution to the regular IRA. In other words, IRA contributions made after age 70½ cannot be used as QCDs, thereby putting the kybosh on the scheme described above. Oh, well. Back to the drawing board…

Example: This is how the new provision works. Adrienne, 75, works part-time and has a regular IRA. She decides to make a tax-deductible contribution to her regular IRA of the maximum for 2020, which is $7,000 (unchanged for 2020). Adrienne, who has a soft spot for charity requests that a QCD in the amount of $10,000 be sent to her favorite charity also in 2020. The Internal Revenue Code views this combination as double-dipping. Adrienne cannot combine both the $7,000 deductible contribution and the $10,000 tax-free QCD. Her otherwise tax-free QCD is reduced by the amount of the post age 70½ contribution to the IRA, essentially causing $7,000 of her $10,000 QCD to be taxable. And it's even worse than that!!! Keep reading.

The new rule also **aggregates** post age 70½ contributions for **all** years and saves them. This means that an unsuspecting IRA account holder could make a post age 70½ contribution to a regular IRA in **one** year and then cause a QCD to be made out of the IRA several years **later**. The result is that the cumulative amount of post age 70½ contributions would offset the tax-free nature of the QCD up to the amount of the cumulative post age 70½ contributions, which would be taxable. This is because a QCD is deemed to have been made out of post age 70½ contributions **first**, due to application of the LIFO rule discussed earlier. Therefore, if you're going to make post age 70½ contributions to a regular IRA, you must keep accurate records of the cumulative amounts of these contributions and know that a QCD could be partially or completely subject to taxation.

Example: This is an example of the aggregation rule. Etienne, age 71, who works part-time and has wages, makes a tax-deductible contribution to his IRA in 2020 of the maximum permitted in that year, $7,000, and repeats this at the same amounts in years 2021-2024, for a cumulative running total of $35,000 in post age 70½ contributions to a regular IRA. In 2025, he makes what he thinks is a QCD of $50,000 out of his regular IRA. Unfortunately for Etienne, the post age 70½ contributions flow out **first** in the LIFO order, transforming the otherwise non-taxable QCD into a **taxable** amount of $35,000!!!

This QCD anti-abuse rule prevents individuals from deducting contributions (above-the-line deductions that reduce a taxpayer's AGI) to a regular IRA and then donating those contributions on a **pre-tax** basis (as a QCD), particularly in scenarios where they otherwise were not itemizing deductions and, thus, couldn't have otherwise made a deductible charitable contribution.

Despite this QCD anti-abuse rule, which really is a **trap for the unwary**, there are a few ways to minimize its effect. For example, married spouses who each have their own IRA can choose to use an IRA of one spouse to receive post-70½ deductible **contributions** and the IRA of the other spouse to make **QCDs**. Additionally, regular IRA contributions can be voluntarily removed if done by October 15 of the year following the year in which the IRA account holder made the contribution. Thus, if an IRA account holder makes a tax-deductible contribution to a regular IRA, but then decides that he or she would prefer to make a QCD, the regular IRA account holder can withdraw the IRA contribution within the allowable timeframe discussed above, preventing any reduction to his or her QCD.

A third option would be for regular IRA account holders to simply make QCDs from their regular IRAs in such an amount that exhausts QCD-disqualifying IRA contributions as quickly as possible. The effect of that strategy means that taxable income will be reported for those IRA account distributions. However, charitable gifts may be reported as itemized income tax charitable contribution deductions, which means that future QCDs will be unaffected by these contribution amounts. It could be that the income generated by these distributions could be partially or wholly offset by the income tax charitable contribution deduction. You have to run the numbers, so consult your tax and estate planning advisors.

Qualified Charitable Distributions. QCDs are tax-efficient means of making charitable dreams come true

today as donations to your favorite charity with funds from a **regular** IRA, i.e., not a qualified retirement plan, Roth IRA, or an inherited regular IRA.

Essentially, a regular IRA account holder (or beneficiary) who is age 70½ or older (the SECURE Act left this minimum age provision alone) can transfer up to $100,000 each year **directly out of the IRA** to a qualified **public** charity, i.e., not a private foundation, donor advised fund or supporting organization. While the QCD counts toward the annual RMD, it is **not** included in adjusted gross income (AGI) of the regular IRA account holder or beneficiary. Of course, one doesn't get an income tax charitable contribution deduction for a QCD, but it isn't income either.

The decision about making a QCD involves evaluating a number of factors. These include using alternative income tax-efficient means to make charitable contributions other than through a QCD from an IRA. One way is donating highly appreciated stock in a taxable brokerage account, which avoids potential capital gains taxes from selling the stock outright.

The SECURE Act's repeal of the age limit cap on regular IRA contributions, together with its introduction of the QCD anti-abuse provision discussed in the preceding section, unnecessarily complicates the coordination of contributions to regular IRAs made after age 70½ and QCDs. However, charitably inclined donors should be able to continue to make QCDs successfully with the alternatives discussed above. Should you have any questions, please consult your estate planning and tax advisors.

Extension of the age for taking RMDs from 70½ to 72. The SECURE Act extends the age for having to take RMDs from 70½ to 72. Technically, a regular IRA account holder and a beneficiary must ordinarily begin taking RMDs by April 1 of the year following the year that the account holder or beneficiary attains the age of 72 or retires, whichever occurs last. RMD calculations are **serious business** because the penalty for failing to take an RMD is **50%** of what should have been distributed, which is a **draconian penalty**.

Loss of Lifetime Stretch for most non-spouse beneficiaries of a regular IRA. One tried and true technique for folks with large IRAs is to structure the distributions over a younger person's life expectancy, which allowed the IRA to continue to grow income tax-deferred. The SECURE Act limited the lifetime stretch to **ten years** for most non-spouse beneficiaries. There are some important exceptions for disabled beneficiaries. Importantly, however, spouse beneficiaries can still recalculate life expectancy and stretch IRA benefits over remaining life expectancy, maintaining their "super beneficiary" status even after the SECURE Act changes.

Conclusion. These four changes could **significantly** impact how taxpayers plan with qualified retirement benefits and IRAs. You definitely should consider discussing these changes with your estate planning and tax advisors.