Stidham Financial Services

Diffusing the SECURE ACT Tax Time-Bomb

Meet Your Hosts

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Why Should You Care?

"In America, there are two tax systems: One for the informed and one for the uninformed. Both are legal." ~ Learned Hand

In the dead of night on December 19th, 2019, Congress voted in an astonishingly unusual and forgotten show of bipartisanship (368-143) to approve the SECURE ACT. Most Americans are unaware of this legislation as all our attention and that of the media were focused on the impeachment and the following pandemic. The bipartisan approval and the timing of this bill should command all of our attention. It certainly took our breath away to the extent that we felt compelled to dig into this bill and report the facts to you.

In short, The SECURE ACT effectively changed the rules on inherited IRAs. Without an adjustment, or at the very least, a review of your current investment strategy, you may be leaving your children with a potentially devastating & unintended tax problem.

We thought it a good idea to inform as many people as possible about these significant mutations Congress has implemented in what could arguably be described as the "*shadiest*" of circumstances.

The following document is a transcript from a free webinar we created to unpack the positive and negative effects of The SECURE ACT. Of course, the consequences of this legislation will vary with individuals based on their specific situations and that of their children.

We want you all to pass on your legacy and bless your children and grandchildren in the manner that you intended when you initially created your inheritance plan.

So please, feel free to reach out to us at any time if you'd like a free consultation to assess any potential complications The SECURE ACT may have caused to your legacy.

There are many ways to mitigate the potentially disastrous tax problems and evaporation of your children's government benefits caused by this legislature.

Set up a meeting with us by clicking **HERE**

Email us to set up a free consultation today by clicking **THIS LINK**

Or you can reach us by phone at (877) 248-8828

If you prefer to watch a recorded seminar with this content, **CLICK HERE**

Daniel Stidham: Hi, everybody, my name is Daniel Stidham. I'm the president of Stidham Financial, and thank you all for joining us today in our conversation about The SECURE ACT. I'm joined here today by Mr. Nick Corry, one of the attorneys that we work with. He's headquartered out of the Little Rock office. Nick, why don't you tell everybody a little bit about yourself?

Nic Corry: I'm a tax and estate planning attorney, I primarily practice in Little Rock. I'm licensed in Tennessee and Arkansas, and I've got a Masters in Law and Estate Planning from the University of Miami.

Daniel Stidham: So, Nick is the only attorney that I've ever met who decided that after four years of college and three years of law school, he just wanted to spend more time in the classroom; he got a Masters in Estate Planning. Since he's also a tax attorney, his main job is to keep us all on our toes and informed of different changes that are coming down the pipe legislatively, because in our firm we are constantly looking out for what's coming down the road. Any of the plans that we create today, whether they be asset protection or estate plans for our clients, are only good so long as the laws stay the same as they were at the time they were created. And that doesn't happen. So, as Nick keeps us aware of what's coming, we call on our clients [to] make sure we put any [necessary] tweaks on their plan. This way it still works the way they had originally envisioned.

In May of last year, Nick let me know that the SECURE ACT had passed the House of Representatives. Now, that personally alarmed me because, as we like to joke, our Congress can't make up their minds on what time to have lunch together. So, to see a piece of legislation passed with such bipartisan support, to say it got my attention is...is...really an understatement. Apparently, the most divided house of our Congress is the House of Representatives. So going into the SECURE ACT, we assumed that it was going to get support further up the line...and in fact, very shortly after that, both the Senate majority leader and the President said that they would sign it immediately when it got there. So, we've been acting since May and preparing with all of our clients as if this was going to pass. And then, in fact, it did and it went into effect on the 1st of this year.

So just to catch everyone up, what is the SECURE ACT?

Our government loves acronyms. So, the SECURE ACT stands for **Setting Every Community Up for Retirement Enhancement**. And one question that we have pondered and that we pose to all of you now is, is that what it does for you? Personally, I think it's a little deceptive. Let's talk about why.

Remember, when our government changes laws, they almost universally use a "carrot and a stick" approach. What I mean by that is they like to distract us with what's in it for us, what I call the "carrot" in front of our faces. These are the good parts of the changes to the law. In the meantime they're hoping that we don't notice the "stick", large as it may be, waiting to crash down on our heads.

Daniel Stidham (cont): So, from a carrot and stick approach, let's talk about the "carrot" first. What's in it for all of us? Quite frankly, and unfortunately, if you do any research on a SECURE ACT, most of what you will hear about is the "carrot". So, tell us a little bit about its effects on retirees, which is primarily our talking point today, Nick.

Nic Corry: The SECURE ACT increased the minimum age at which you must start taking required minimum distributions. Prior to the SECURE ACT, it was 70 and a half. So, by the time a retiree or account owner reached the age of 70 and a half, they had to start taking the required minimum distributions calculated based on their life expectancy. The SECURE ACT helped account holders by increasing that to age 72.

Daniel Stidham: So, this passed in January. What happens if, say, a 71-year-old had just started taking the required minimum distributions? What happens to them? Because now it's been pushed off to 72.

Nic Corry: Basically, if you reached 70 and a half prior to January 1st of 2020, you're under the old rules.

Daniel Stidham: Grandfathered in, so to speak.

Nic Corry: Well, in this case, you'd actually want the new rules because you wouldn't have to start taking the required minimum distributions for another year and a half.

Daniel Stidham: So, *grandfathered out*.

Nic Corry: Basically grandfathered out, yeah.

Daniel Stidham: The next thing that it does is it affects your IRA contributions. Prior to the SECURE ACT, you had to cease those contributions at the time you began taking the required minimum distributions at 70 and a half. You can now continue to contribute to those accounts. However, that's really, to me, a point that sounds fantastic, but we almost never see anybody utilize that. Most people stop contributing to those accounts at the same time that they retire...and very few of our clients, at least, work past the age of 70 and a half, much less 72.

Nic Corry: Right.

Daniel Stidham: So, the "carrots"...to me, they just don't add up to a whole lot of carrot. I mean, you get an extra 18 months worth of growth enabled to compound any of the gains you had prior to that...but then also, just as likely, you could lose money in that 18 months, right, if we have a market correction? And 18 months in the span of someone's life, up to that point, I don't see it being as big a deal as what has been trumpeted. But then again, I don't guess it has been trumpeted that much because the SECURE ACT actually passed in the dead of night in the middle of a Presidential impeachment. Most people don't even know that it is in existence, right?

Nic Corry: I would say that most people have never even heard of The SECURE ACT.

Daniel Stidham: I know I've done this and you have as well. When we approach our clients and when we speak to them we say, "*Hey, we need to bring you in and see how this change affects you.*" Most of them are completely unaware of it, aren't they?

Nic Corry: They are. And the "stick" aspect of this is very detrimental to older estate plans, especially ones utilizing trusts. Prior to the SECURE ACT, that was pretty much the correct way to plan for a subsequent generation inheriting an IRA through the use of some specialized trusts. After the SECURE ACT, there have been horrible consequences. It's actually worse than the "stick" we're about to talk about.

Daniel Stidham: Nick has a very valid point, but for today's quick lesson, we will table that. However, if any of you have questions on that, please don't hesitate to send us an email. We'll set up a time and talk to you about it. That is my gift to you. <u>We'll never send you a bill for that</u>. When it comes to the stretch IRA, I think that's where we're going to see the most universal effect of this, right?

Nic Corry: Right, and that's a substantial stick. The SECURE ACT was designed to be revenue neutral. Congress estimated that what they were giving up in income tax by allowing another year and a half of deferrals until the required minimum distributions, they were going to more than make up by using the other provision of the SECURE ACT. **That is basically getting rid of stretch IRAs.**

Daniel Stidham: So what is a stretch IRA?

Nic Corry: Prior to the SECURE ACT, if a non-spouse...

Daniel Stidham: Children, basically?

Nic Corry: Basically children or grandchildren. If they inherited a qualified plan, they still had to take required minimum distributions. But they got to use their own life expectancy to determine how many of those required minimum distributions they took.

Daniel Stidham: So basically, that means that if I inherited an IRA after the death of a parent or grandparent, I got to stretch the tax consequences of those distributions out over the span of the estimate of the remaining of my life, right? So, very small tax amounts would ever be paid out of that?

Nic Corry: Right. If you were 40 when you inherited that, you'd have about 45 years to take those required minimum distributions. So that's about 2% or 2.5% out in year one, and that percentage goes up every year. But, it really deferred the taxation and gave the account a lot longer term to grow tax free. After the SECURE ACT, if anyone who is not a spouse inherits a qualified account, <u>they have 10 years to take it all out</u>. You can take it all out in year one, all out in year ten, or take it any combination in between.

Daniel Stidham: One of the questions that I see is, "*What is a qualified plan?*"

A qualified plan is the group tax lumping together of any pre-tax dollars. In other words, these plans are *qualified* to invest pre-tax dollars, which means they grow tax deferred and these could be things like a traditional IRA or a 401k. Those are probably the two most common. But you also see things like a 403(b) or 457 in many cases and those are really just coded based off of their place of employment. But they all mean the same thing. And that means that you invested for retirement *before* paying taxes on the money. That also means that when you make those withdrawals in retirement, whether they be forced or otherwise, they're taxed as income.

Nic Corry: Ordinary income.

Daniel Stidham: And therein lies more of the "stick", right?

Nic Corry: Right.

Daniel Stidham: So, let's look at a case study, because a lot of this stuff really doesn't hit home until you see how it can hit in *your home*, right? So, tell us about Susan.

Nic Corry: Susan is 55-years old. She's a nurse and she's hitting the stride of her income production. She's making $85,000 a year. Then she gets the bad news that her father passed away. Then she gets the good news that he also left her a $500,000 IRA. Prior to the SECURE ACT, her required minimum distribution would be based on an approximately 30-year life expectancy from age 55. After the SECURE ACT, she's got 10 years to take it out.

Daniel Stidham: Wow!

Nic Corry: Let's assume that, out of the $85,000 she's currently making, the last dollar she makes is taxed at the 24% federal income tax bracket. If she takes $50,000 a year, 1/10 of that inherited IRA, that's going to go on her return as ordinary income and the first and last dollar of that $50,000 dollars is going to be taxed at 32%.

Daniel Stidham: So, that means prior to January of this year, she would have been able to take that half a million dollars and pay taxes on it incredibly slowly over the next 30 years. But now all of a sudden, you have 10 years to drain the entire account and pay all of the taxes?

Nic Corry: Correct.

Daniel Stidham: I would say that more than makes up for the revenue lost in letting people stretch out an extra 18 months in their IRA, wouldn't you?

Nic Corry: The congressional estimate was that the change in the treatment of the inherited IRAs is expected to generate 18 billion dollars over the next decade. So, yeah, I think it's going to be more than revenue neutral given the "carrots" that they handed out on the front end.

Daniel Stidham: That, typically for me, is why this was so important that I wanted to do a webinar over it. It has such vast consequences. Your generation, the baby boomers, the people in their 50s...even...you were told your entire working career that you should place money in the company 401k. Your CPA told you that you should put money back in IRAs to save for retirement. Somehow, they told you and convinced you that you would be paying a lower tax bracket later on than what you would be in retirement. I've never seen that, but that was a big argument that you heard for years and years. And then consequently, you saved everything you intended to pass on to your children, or at least the bulk of it in these qualified accounts. *The federal government just ripped the rug right out from under you****, and it will be your children that end up falling flat****. So, in this case example of Susan, if you do the math, that's $160,000 in Federal taxes that she'll have to pay out of that IRA over the next 10 years. Now, Susan, may just be an example and obviously, we don't know her father. But I'd wager a guess that he didn't plan on 32% of what he was saving and leaving behind for his daughter to go right back to the Federal government, much less that quickly, huh?

Nic Corry: Definitely not in 10 years.

Daniel Stidham: That's just Federal taxes. In our Tennessee offices, we don't have to worry about anything but Federal taxes, but in our Arkansas offices, we'd have another 6% in state income taxes on top of that, right?

Nic Corry: Yes, right...right at 6%.

Daniel Stidham: And in that example, that would be another $30,000 tacked right on top of that. So it would be $190,000 lost. That's a *big* "stick"!

Nic Corry: And all inside of a 10-year window.

Daniel Stidham: This is just my personal opinion, but I think that's why they did it. I don't think any of this was an accident. I think the "carrot", being able to extend your growth in your IRAs for another 18 months, was just to distract us from noticing how big this "stick" is...because our Federal government is broke. Here we are having just-written laws that printed 4-trillion dollars out of thin air and added to the debt for the coronavirus and now our debt is more as a country than our gross domestic product is.

So, I ask you at home, when you pass away and leave IRAs to your children like this, do you think Nick's numbers are still going to be accurate? Do you think taxes are going to be higher or lower when you pass these IRAs on to your kids? Mathematically, I don't see any way that we can have this record high national debt and still keep record low tax brackets like we've had. I think that these numbers are going to come in way below what they actually will be for most of the people joining us today.

Daniel Stidham: Let's look at another example. Paul is 69-years old and Paul is retired, drawing his Social Security and paying the smallest Medicare premium...the basic Medicare premium of $135.30 a month. Paul has had the luck of being able to have his mother in his life for 92 years or at least 92 years of her life. But then she passes away and, again, leaves $500,000 in an IRA to him. Now, because Paul is drawing on his Social Security and because he's drawing on Medicare, the consequences are going to be a little bit different for him at 69, then they're going to be for Susan at 55, right?

Nic Corry: Absolutely.

Daniel Stidham: Well, now we're getting into government benefits and government benefits are all means-tested, aren't they? At least most of them.

Nic Corry: The vast majority of them in some form or fashion are subject to a means test, yes.

Daniel Stidham: And for those of you at home that don't understand means testing, basically what it means is that every government benefit that we're expecting in retirement in some form or fashion, regardless of the fact that they made you pay taxes into it throughout your working career, there are now some form or fashion of a welfare program, right? If you have too much income or you have too much in assets, you either are punished for that financially or you are just flat out disqualified from the programs, right?

Nic Corry: Right.

Daniel Stidham: So, let's look at the effect of Medicare on that. Along with the $160,000 in taxes that we just discussed in Susan's example, that would have to be paid in the first 10 years...again, this is accounting for no gain in the account during that entire 10-year period...and again, this is aside from any state income taxes that Paul may have to pay...his Medicare premium now is increased all the way to $352 a month. That's a big increase, but it's going to be increased throughout the entire 10-year period, right?

Nic Corry: If he takes out the required minimum distribution equally over the 10-year span, yes. It would be every month through that 10-year window.

Daniel Stidham: And he'd almost have to do it over the 10-year span, right? The tax consequences of doing it in 2 or 3 years or all at one time would be even more severe than what we're discussing today, wouldn't they?

Nic Corry: More than likely, yeah.

Daniel Stidham: So, with that in mind, let's do the math again.

Daniel Stidham: That increased Medicare premium over the same 10 years that Paul has to pay all these taxes...that's an extra $26,000 he has to pay in that Medicare premium. But here's the kicker; the taxes that Paul has to pay out of the IRA in that 10-year span, that's his mom's money, right?

Nic Corry: Right.

Daniel Stidham: But the $26,000 he has to pay in increased Medicare premium over that span of time, that's out of *his pocket*, isn't it?

Nic Corry: It is.

Daniel Stidham: So, these examples are just two of many, because every one of you, every one of us, we have our own unique set of circumstances. Our accounts will be different sizes. Our families will be structured in different ways. Their government benefits or lack thereof, or the incomes that they have and are taxed off of will all be different, won't they? So, keep that in mind when you look at these examples and ask yourself this question: ***"How will this affect my children?"***

When you look at that example of how it would affect your children, when you ask yourself that question, another question that you should be asking yourself is, "*How do I address this and who do I need to help me?*"

Just speaking from the financial side, I can tell you that when most people try to address a problem, they just go to their advisor's office. That's it. They go to one person to address a problem without knowing that...that problem *at least* bleeds over into other areas. Especially in retirement, when we're talking about government benefits and them being means tested. So, on the financial side, I would recommend, *in fact, it's a necessity*, that you have several different professionals help you address this. Examples of this would be a registered investment advisor, your financial advisor, a certified retirement financial adviser. That is a very specific designation of advisor that focuses on issues for retirees and seniors. I'm proud to be one of about 101 in the United States. And let's not forget to include a CPA, because, as we just mentioned, these have tax consequences. We need to make sure that as we're trying to plan around this, we know the pros and cons of doing things in different ways. But insurance professionals, because you need to know how this is going to affect or maybe require different types of insurance on you or your kids. And then, if you can find one, a certified Social Security Advisor. We're lucky enough to have one, but they are few and far between. When we're talking about government benefits, those are the professionals who, even beyond Social Security, will tell you what the impact is of every move that you make on your benefits.

Give us some examples of the professionals that we use in our office when dealing with this issue.

Nic Corry: The SECURE ACT in general, and any other inheritance planning, should be discussed, at least, with an estate planning attorney and/or a tax attorney. Additionally, depending on stage-in-life, you may consult with an elder law attorney or a VA accredited attorney. You could ask a question about your particular circumstances with the SECURE ACT to pretty much anybody we just named. But, they wouldn't necessarily know what impact and change to, who you leave your IRA to, is going to affect all of these other accounts and issues that are usually managed by other professionals.

Daniel Stidham: Here are a couple of examples of that and some questions that I see on that, since we have a VA claims attorney on that list. *Why would a VA claims attorney be involved in any planning or preparation involving The SECURE ACT?* They don't seem to be at issue here in any way. But as we just showed Paul having effects on his Medicare premium because of the way the government is now forcing him to take his parent's IRA and inheritance, the same could be said about our veterans. Our veterans, unfortunately, have had most of their benefits as well, means tested. This means if they have any sort of an income or assets and they need help that they so very much deserve, a lot of times they will be disqualified because of those incomes or those assets. If you have a veteran as a son or a daughter that you're leaving these IRAs to, it could very well knock them out of those benefits, right?

Nic Corry: Absolutely.

Daniel Stidham: And why so many different professionals? I get that question a lot, too. I think it really boils down to the fact that we just don't know what we don't know. So many times people will go to one professional to address an issue, to get an answer to a question. The answer they get might be the very best answer in that particular field of expertise. But it may have devastating consequences in other fields. The biggest example that we see are trusts. You're a tax attorney, so you're a little different. But very often, we see trusts where attorneys alone were involved in the planning, and most of the time they tell people to leave their IRAs to the trust. This can have a devastating consequence, right?

Nic Corry: Yes. Actually for a trust it's worse than the 10-year required minimum distribution under the SECURE ACT. Prior to the SECURE ACT, having a trust as a beneficiary of an IRA had some possible advantages. And afterwards, those are all gone. And doing so is actually worse than the 10-year payout. So, it's very important to talk to at least one professional on this list, if you had previous estate planning documents that were in place prior to the SECURE ACT becoming effective in January of 2020.

Daniel Stidham: I don't think that that's because the attorneys who set up the estate plans do anything wrong, necessarily. Their job is to give legal advice. Most of the time they don't know the tax consequences of leaving IRAs to trusts. And a lot of times they don't specifically say, "*Hey, you need to leave your IRA to the trust.*" They typically say something like, "*Hey, your instructions and everything are laid out in this trust and you need to make sure everything is left to it.*" Kind of a blanket statement like that.

Daniel Stidham (cont): Whereas when we take on a case, because we have all these professionals and more, before we ever sign off on a plan, we make sure we've gotten approval from all of these professionals in their area of expertise to make sure the plan doesn't cause problems in their particular field, correct?

Nic Corry: Right. And we continue to go back and review that plan as life marches along because none of these plans exist in a vacuum.

Daniel Stidham: Yeah, a plan is really only good until the next time they change the laws that govern it, right?

Well, guys, thank you for joining us today. I hope that you all learned something.
If nothing else, I hope that you became aware of something that could potentially have some devastating consequences on the legacy you plan to leave your children and your grandchildren.

For those of you who stuck around all the way through, we have a special gift and a thank you....we are going to be sending out an e-mail to you, welcoming any questions that you may have that either came up during the course of this conversation about the SECURE ACT or just questions that you may have in general. We will make sure that we get you answers to your questions, even set up a telephone call or maybe even an in-person meeting. And that's on me. It's my gift to you. You will never get a bill. Thanks again for joining us. God bless and good luck.

Once again, please reach out for a free consultation to ensure that all your retirement plans will continue to stay true to your initial vision in the wake of the passing of The SECURE ACT.

Set up a meeting with us by clicking **HERE**

Email us by clicking **THIS LINK**

Or you can reach us by phone at (877) 248-8828.

You will not be charged for this consultation.