TFC FINANCIAL
The Financial Counselors

FINANCIAL PLANNING UPDATE
December 2020

OUR VIEW

The SECURE ACT eliminates the "stretch" IRA by requiring inherited IRAs to be fully distributed within 10 years after the death of the original IRA account owner. This is a significant development that impacts many estate plans.

2020 Year-End Tax Update

As 2020 draws to a close, it seems safe to say that most of us are looking forward to the dawn of a new year. One filled with hope and the promise of an effective vaccine that will allow the world to return to what was the "old normal", or as close to that as is possible. With that being said, as we flip the calendar page into December, it is worthwhile to review where you stand from a tax and financial planning standpoint and consider strategies that may be beneficial for your particular situation. In this update we will first review recent tax & retirement plan changes and then outline some key planning strategies for consideration. We will also highlight some items that are worthy of reviewing every year from a planning standpoint. As always, consult with your tax & legal advisors and the team here at TFC to determine whether a particular strategy will help you and your family accomplish your long-term goals.

The SECURE ACT (enacted January 1, 2020):

1. **Perhaps the most consequential change coming from The SECURE ACT is the "death of the stretch" IRA**. Inherited IRAs must now be distributed by December 31st of the 10th year after the death of the IRA account owner (the "10-Year Rule"). This applies to most beneficiaries, with 5 exceptions: surviving spouses, disabled persons, chronically ill persons, a beneficiary not more than 10 years younger than the decedent, and the decedent's minor children (only until they reach the age of majority). In years one through nine there are no Required Minimum Distributions ("RMDs"), but the total inherited IRA must be emptied by the end of the 10th year.
2. **The Act changed the rule for Required Minimum Distributions which now must begin at age 72, no longer at 70 ½**. RMDs must begin no later than April 1st of the year after reaching age 72.
3. **Elimination of the maximum age for traditional IRA contributions.** IRA contributions may now be made at any age as long as there is compensation on which to base the contribution.

Strategies in response to the SECURE ACT changes:

1. **Review IRA and Other Retirement Account Beneficiary Forms** and determine whether changes should be made. Many estate plans include naming a trust as the beneficiary of an IRA. This was previously a sound way to protect a significant legacy asset from creditors and to ensure an orderly distribution of the assets to the trust beneficiaries. Due to the 10-year rule, the language in many trusts would cause one large distribution to be made in year ten, driving up the tax liability and handing the beneficiaries a lump sum that they may not be equipped to handle. Estate planning attorneys can provide counsel on whether new trusts should be drafted, or beneficiaries changed in concert with the overall estate plan.

The minimum age for making Qualified Charitable Distributions from an IRA remains at 70 ½, whereas the age to begin taking Required Minimum Distributions was changed to age 72.

2. **Consider a conversion of a Traditional IRA to a ROTH IRA.** Part or all of a traditional IRA can be converted to a ROTH IRA. Taxes are due on the amount converted in the year of conversion just as if you took a distribution from the IRA outright. But future distributions from a ROTH IRA are tax-free (after certain requirements are met). Unlike a traditional IRA, there are no required distributions from a ROTH IRA while the account owner is alive. A ROTH IRA is deemed a very good asset to earmark for future generations due to the tax-free nature of the distributions. Inherited ROTH IRAs are still subject to the 10-year rule, but without the tax burden that comes with an inherited traditional IRA.

3. **Consider Qualified Charitable Distributions (QCDs) from your IRA** and perhaps naming a charity as the beneficiary of your IRA. The SECURE ACT did not change the minimum age (70 ½) for distributing funds to one or more qualified charities from your IRA as a way of satisfying your Required Minimum Distribution ($100,000 maximum). The amount of the QCD will not be treated as income, having benefits such as potentially lowering your Medicare premiums. Those who have named their favorite charities in their estate plans may consider naming the charities as IRA beneficiaries, while leaving more tax-efficient assets to their loved ones. If you have set up a donor-advised fund, you may also consider naming that as a beneficiary of your IRA.

The CARES ACT (signed into law on March 27, 2020):

The CARES ACT provided over $2 Trillion of economic relief for American workers, families, and small businesses.

1. **As part of the CARES ACT, Required Minimum Distributions (RMD) from retirement plans were waived for 2020.** Although distributions from IRAs and 401ks and other retirement plans were still allowed, they were no longer required for those over age 72 or who were required to take distributions under prior law. There was a window for those that had already taken their RMDs to recontribute back into the distributing IRA by August 31, 2020 if they chose to do so.

2. **The 10% early withdrawal penalty from retirement plans will not apply to Coronavirus Related Distributions for 2020.** Certain requirements must be met, but those directly impacted by the virus can avoid the 10% penalty on early distributions and are allowed to spread the income and resulting tax over 3 years. Distributions must be made by year-end to qualify.

A ROTH IRA is deemed a very good asset to earmark for future generations due to the tax-free nature of the distributions.

Strategies in response to the CARES ACT:

1. **Consider ROTH IRA Conversions up to the amount of the waived RMD for 2020.** The benefits of a ROTH IRA have been noted above. If you convert the amount of a RMD instead of recontributing back into your IRA, you would be in the same tax situation this year had you taken the RMD as usual. Yet you would now have that amount in a ROTH IRA account, growing tax free (for you or your heirs) and not subject to required distributions during your lifetime.

2. **For those taking early withdrawals from a retirement plan,** consider projecting income levels for 2020 through 2022 to determine the optimal strategy for claiming the income. The CARES ACT also allows for repayment to the plan at any point over the three years which will be treated as a tax-free rollover.

Consider the impact of tax-loss or tax-gain harvesting will have on your tax situation over a multi-year horizon.

Year-end Planning Items:

1. **Quarterly estimated tax payments** may be due if you have not adequately met the safe harbor rules through tax withholding. For those with state income tax payments due, consider whether it makes sense to pay before or after December 31st. With the potential for the state and local tax ("SALT") deduction limitation to be eliminated under a Biden administration, it may be beneficial to pay after January 1st. You will have to consider the probability of tax changes being effective January 1st, 2021, but if the SALT deduction limit of $10,000 is already met for 2020, consider waiting until 2021. Remember that failure to pay in sufficient estimated tax could result in penalties. The fourth quarter 2020 estimated tax payments are due by January 15, 2021.

2. **Manage tax brackets** when possible by controlling the timing of income and expenses/deductions. If you have variable income (bonuses, stock compensation, deferred compensation) where you have control over the timing, determine what year to realize the income. The general expectation is that income tax rates will rise, but your specific situation should be reviewed with your tax advisor to minimize the total tax impact using a multi-year view.

3. **Consider the potential impact of capital loss harvesting or capital gain harvesting in 2020 vs. future years.** Traditionally we are often focused on strategies to defer taxes, leaving a greater amount invested to grow. With the prospect of higher tax rates in the future and potentially lower taxable income this year for many due to waived RMDs or lower earnings, it may make sense to harvest gains. For married couples filing jointly, long-term capital gains have a 0% tax bracket up to $80,000 of income and 15% for income up to almost $500,000. The Biden administration's proposal would tax long-term gains at the same rate as short-term rates for those with incomes over $1,000,000. That change would essentially double the tax rate on long-term gains to almost 40%. Those expecting to be in that income range and especially those with concentrated, low-basis securities may want to consult with their tax advisor to consider taking some gains this year.

A special rule allows for "super funding" 529 plans with up to 5 years of annual gifts ($75,000 for an individual or $150,000 per married couple) which can help jumpstart a college savings account.

Additional Strategies to Consider:

1. **Make Annual Exclusion Gifts before year-end.** An individual may give up to $15,000 per beneficiary to as many individuals as he or she desires, without the necessity of filing a gift tax reporting form and without utilizing any of their lifetime gift and estate exemption amount (currently $11.58 million per individual). Although this strategy does not save current taxes, by moving assets (as well as the future growth of those assets) out of one's estate, it could save estate taxes down the road and is an excellent wealth transfer strategy.

2. **Consider funding a 529 college savings plan.** These plans remain a key component of saving for college and can be utilized by parents, grandparents and other relatives (note there is different treatment under financial aid rules for 529 plan accounts owned by non-custodial parents). A special rule allows for "super funding" 529 plans with up to 5 years of annual gifts ($75,000 for an individual or $150,000 per married couple) which can help jumpstart a college savings account. Qualified withdrawals from a 529 plan are tax-free and cover a wide range of educational related expenses.

The CARES ACT permits eligible individuals who do not itemize deductions to deduct $300 of qualified charitable contributions as an "above the line" deduction.

3. **Charitable Contributions.** The CARES ACT permits eligible individuals who do not itemize deductions to deduct $300 of qualified charitable contributions as an "above the line" deduction. There may be a small tax benefit for those giving to charity who claim the standard deduction. Those considering larger charitable gifting may want to consider opening or adding to an existing Donor Advised Fund (DAF). A DAF provides an efficient way to bunch gifts to maximize a charitable deduction in one year while distributing gifts to charities over several years. Ease of administration and recordkeeping are other reasons why DAFs have become very popular over the last several years.

Please contact your tax advisor in collaboration with your TFC advisor with questions or to review how these changes may impact your personal situation.

Best regards,

Michael J. Meehan, CPA/PFS, CFP®
Senior Client Advisor

TFC Financial Management, Inc.
260 Franklin Street, Suite 1888, Boston, MA 02110
p 617.210.6700 | f 617.210.6750 | www.tfcfinancial.com