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TAX LAW SPECIAL REPORT

WHAT'S THE BIG DEAL ABOUT THE SECURE ACT?

By Nathan Hannah

I have been getting questions about the SECURE Act. That's legislation recently adopted by Congress that changes certain rules governing the tax treatment of retirement accounts, including when you can put money into or take money out of such accounts. The change that has been talked about the most in estate planning circles is that the Act shortens the time that beneficiaries have to withdraw the money in inherited retirement accounts.

A little background is in order. As I am always reminding people when discussing their estate plans, retirement accounts are typically dealt with outside of your will or trust. That's because the owner of a retirement account has the ability to name a beneficiary for it. If there's money left in the account when the owner dies, the account becomes the property of the named beneficiary. This is true even if the account owner's will or trust says something different. The retirement account will not be included in the account owner's probate estate, or his or her trust, unless the account owner names his or her estate or trust as the beneficiary.

When the beneficiary becomes the owner of the retirement account (which at that point is commonly referred to as an inherited IRA), the beneficiary has a decision to make: withdraw all the money now, or withdraw it over a period of time. And why, you may ask, would someone

want to spread out withdrawals from the inherited IRA over a period of time? Why not withdraw all the money now?

The answer to that question is, because withdrawals from that inherited IRA are taxable income to the new account owner. By spreading the withdrawals out over a period of time, the new account owner can defer paying tax on those funds.

Now back to the SECURE Act. The Act shortened the time that the beneficiary has to withdraw the funds from the inherited IRA. That means the funds will be taxed sooner. The basic new rule is that except for certain classes of beneficiaries, including surviving spouses, minor children, and disabled individuals, the beneficiary of an inherited IRA must withdraw all of the funds within ten years after the owner dies.

That change could result in a much shorter withdrawal period than some retirement account owners were counting on under the old rules. Those account owners were planning on leaving the accounts to their adult children and expecting

QUOTE OF THE MONTH

It is better to live rich than to die rich.

Samuel Johnson,
English author, critic, &
lexicographer (1709 - 1784)

that their children would take more than ten years to withdraw all of the funds.

My guess is that more retirement accounts are inherited by surviving spouses than by children of the account owners. Since surviving spouses are excepted from the new shorter withdrawal period rule, the number of people actually impacted by the new rule may be smaller than it sounded like when the change was announced.

Another change included in the SECURE Act might affect a much larger number of retirement account owners: the age at which account owners will be required to start making withdrawals from their retirement accounts (the dreaded “required minimum distributions,” or RMDs) will increase from 70 ½ to 72 for account owners who weren’t 70 ½ yet at the end of 2019.

I probably should have started this discussion with a disclaimer, but since I didn’t, here comes the disclaimer: this is a simplified discussion of a complex topic that would take much more space than I have here to cover in any comprehensive way. If you have retirement accounts that you think might not get fully spent while you are alive, and you’re concerned about the tax treatment of those accounts when they are transferred to your beneficiaries, I urge you to consult a qualified tax advisor about it.

The SECURE Act made other tax law changes that I have not discussed here but that may be significant in your situation. I again urge you to consult a qualified tax advisor before making any financial or estate planning decision that could affect your tax situation.

AVOID TAX TROUBLE

Since it is tax season, you might want to check the IRS’ “Dirty Dozen” list of twelve prevalent tax scams. Here’s last year’s list from the IRS’s

most recent news release on the subject (IR-2019-49, Mar. 20, 2019):

- Phishing
- Phone Scams
- Identity Theft
- Return Preparer Fraud
- Inflated Refund Claims
- Falsifying Income to Claim Credits
- Falsely Padding Deductions on Returns
- Fake Charities
- Excessive Claims for Business Credits
- Offshore Tax Avoidance
- Frivolous Tax Arguments
- Abusive Tax Shelters

I thought it would be interesting to compare the latest list with the IRS’s news release on the same subject five years ago. Here’s their list of the “Dirty Dozen” for 2014 (IR-2014-16, Feb. 19, 2014):

- Identity Theft
- Pervasive Telephone Scams
- Phishing
- False Promises of “Free Money” from Inflated Refunds
- Return Preparer Fraud
- Hiding Income Offshore
- Impersonation of Charitable Organizations
- False Income, Expenses or Exemptions
- Frivolous Arguments
- Falsely Claiming Zero Wages or Using False Form 1099
- Abusive Tax Structures
- Misuse of Trusts

The list didn’t change much, did it? The 2019 news release includes this timely reminder from the IRS: “Taxpayers should remember that they are legally responsible for what is on their tax return even if it is prepared by someone else. Consumers can help protect themselves by choosing a reputable tax preparer.”