Resource
Brokerage, LLC

The SECURE Act Has Me Thinking!

By: Blair Farwell

In layman's terms, the "stretch IRA strategy" would allow the recipient of the IRA to look at IRS tables and take distributions from the inherited IRA over the course of their expected lifetime. Therefore, the impacts of "inherited" income on the recipient's tax bill could be minimized on an annual basis and the cumulative payouts over the rest of the recipient's lifetime could be quite large!

The passage of the SECURE Act now has changed this approach!

The SECURE Act states that beneficiaries (other than spouses) have only 10 years to liquidate the full balance of their inherited IRA. The law is silent on how the distributions must be taken and allows the person flexibility as long as they meet the 10-year deadline. The distributions are not required to be in equal amounts. In theory, the recipient could do annual distributions or wait until the 10th year and take it all. However, suppose the inherited IRA has a value of $200,000. Think of the tax consequence an increase of $20,000 per year would have on the recipient's yearly tax liability versus the tax consequence of a $200,000 lump sum distribution. I have two strategies that could potentially reduce that liability for both the yearly distributions and/or lump sum distribution.

The first strategy involves the recipient's 401(k). The recipient could max out his/her 401(k) contributions and use the yearly IRA distributions in order to offset any "loss in take home income" as a result of the increased 401(k) contribution. This strategy has two benefits—a reduction in the taxable income of the IRA distribution and an increase in employer match (if offered and the recipient has not reached their employer match limit). Most employees today are not maxing out their 401(k) contributions so this would be an easy way to "receive" the funds but offset any taxable impacts by immediately reinvesting the funds (and take a corresponding tax deduction) until they have maxed out their 401(k) contribution limit. Additionally, individuals aged 50 and over are entitled to contribute greater amounts in a 401(k) in an effort to catch up or make up for lower contributions made while they were younger. If you have two working spouses filing jointly (both with 401(k) eligibility), the IRA recipient could offset a lot of tax burden here.

But then I got thinking—what about leverage?

While the stretch IRA was a great tool, now that it is gone, what if you looked at a linked benefit program (combination Life/LTC products) that **accept qualified money.**

This second strategy simultaneously fixes three issues:

1) Passes on a death benefit (if the death benefit was not used for LTC) on a tax-free basis not subject to the new SECURE Act 10-year limitation for IRAs,
2) Provides the recipient leverage on their premium dollar (a multiplier on premium commitment day one) whether it be used for LTC or a death benefit, and
3) Since it is a linked benefit program—it carries a guarantee that the policy premiums for LTC coverage will never increase (these solutions are available from carriers A-rated or better).

In summary, I believe the SECURE Act should cause everyone to re-evaluate the distribution strategy of their retirement portfolios. The distribution limitations set by the SECURE Act could potentially inflict tax havoc for your non-spousal beneficiary. Individuals should re-examine their portfolio to ascertain if it is structured to optimize the potential distribution, both from a tax perspective and an intention standpoint. Sound distribution strategies will ensure that your beneficiaries will get the payout in the form and timing you wish versus what the federal government mandated for their own good.

While my blog post is meant to be thought provoking and informative, they are hypothetical in nature and should not be considered or relied upon as legal, tax or client specific advice. You should verify all points with the appropriate counsel and make sure that any recommendations are prudent for your specific client situations before progressing.