SENIOR LAW DAY
COLLABORATIVE

What you need to know to age smart
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Taxes Q&A

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How to use this guide

Senior Law Day Collaborative Q&As are intended to guide older adults and caregivers as they address issues related to aging and planning for the future. We suggest you review this information in the full before seeking out an elder law attorney or other professional, so that you are familiar with the terms and can be ready to ask questions specific to your needs.

At our website – **seniorlawday.info** – you will find:

- additional Q&As for review and download
- a library of recorded webinars on topics relevant to elders and caregivers
- an opportunity to get your specific questions answered via email or during our quarterly consultation events
- notice of upcoming educational programs

All services of the Collaborative are offered at no charge. Our goal is to help you get the answers you need so you can plan and move forward with confidence.

This Q&A was written by Senior Law Day Collaborative member
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Taxes

SECURE Act for Retirement Planning

What is a required minimum distribution (RMD)?

The Internal Revenue Code (the "Code") currently requires retirement plan participants to take certain annual distributions from retirement plans beginning at age 73. The RMD is the amount that must be distributed in a particular year to a plan participant from his or her retirement plan.

In 2033, the age at which retirement plan participants will be required to begin taking annual distributions from retirement plans will be raised to age 75.

Which retirement plans are subject to the RMD rules?

The RMD rules apply to qualified retirement plans. The types of qualified retirement plans that are subject to the RMD rules include traditional IRAs, simplified employee pension (SEP) IRAs, savings incentive match plans for employees (SIMPLE) IRAs, 401(k) plans, 403(b) plans, 457(b) plans, profit sharing plans and other defined contribution plans.

Why do we care about RMDs?

Retirement plans allow participants to accumulate funds inside the plans on a tax-deferred basis. Investing through a retirement plan allows a participant to defer income tax not only on his or her compensation that was originally contributed to the retirement plan, but also to defer paying tax on the growth of and the income earned on the participant's compensation contributed to the plan. Thus, amounts contributed to retirement plans, as well the growth and earnings from amounts contributed, are sheltered from tax until they are distributed to the participant or the participant's beneficiaries.

The RMD rules dictate when this tax-sheltered accumulation must end and when funds must begin being distributed from a retirement plan. These same rules direct how much must be distributed each year.

Once funds are distributed from a retirement plan, those amounts are taxed. Until the participant's compensation and the amount that is earned investing that compensation is distributed, it grows tax-free.

Keeping the funds in the plan enables the participant or beneficiary to reap a profit from investing the original compensation and the income earned on that compensation. Thus, the more time that the funds in a retirement plan are allowed to remain in the plan without distribution, the more the funds will grow.

What does the SECURE Act generally provide?

The SECURE Act generally applies to retirement plan participants who have invested in retirement plans and die after December 31, 2019.

Under the SECURE Act, when a retirement plan participant dies, beneficiaries of the retirement accounts will generally be required to distribute the entire inherited retirement account balance by the end of the tenth calendar year following the retirement plan participant's death. The SECURE Act provides an exception to the "ten-year rule" for five types of beneficiaries.

When must RMDs begin under the SECURE Act?

Prior to the enactment of the SECURE Act, participants in retirement plans were required to begin taking RMDs at the age of 70½ according to life expectancy tables provided by the Internal Revenue Service.

The SECURE Act raises the required starting age for retirement account distributions to age 73 for individuals who turn 72 on or after January 1, 2023. Those retirement plan participants must begin taking withdrawals by April 1 of the year after the participant reaches age 73.

The RMD age changes from 73 to 75 in 2033.

The increase in the required starting age enables retirement plan participants to increase the tax-deferred growth inside their retirement accounts.

Once the plan participant dies, the 10-year rule generally takes effect and the remaining account balance must be distributed to designated beneficiaries within 10 years after the participant's date of death.

What are the exceptions to the 10-year rule?

The 10-year rule does not apply to certain eligible designated beneficiaries.

An "eligible designated beneficiary" is an individual who, with respect to the retirement plan participant, on the date of his or her death is: (1) the surviving spouse of the plan participant; (2) a child of the plan participant who has not reached the age of majority; (3) a disabled individual; (4) a chronically ill individual; or (5) any other individual who is not more than 10 years younger than the plan participant.

How does the "surviving spouse of the plan participant" exception work?

A surviving spouse can also still roll over retirement plan benefits into the surviving spouse's own retirement plan upon the death of the participant spouse and stretch distributions over the surviving spouse's lifetime. In that case, the surviving spouse can name his or her own designated beneficiary for the rollover retirement plan.

After the surviving spouse's death, the SECURE Act will apply to the accumulated funds in the surviving spouse's retirement plan.

In order to be considered an eligible designated beneficiary under this exception, the surviving spouse must have been legally married to the decedent.

How does the "minor child of the plan participant" exception work?

The SECURE Act provides that a child is an eligible designated beneficiary of a deceased retirement plan participant if the child is the sole designated beneficiary of the plan and has not reached the age of majority.

Once the child attains the age of majority, then the 10-year rule starts and anything remaining in the inherited plan must be distributed within 10 years after that date. This changes distributions from annual distributions over the life expectancy of the child to discretionary distributions completed by the end of the tenth year after the child reaches the age of majority.

For example, Agatha dies in 2023, leaving her IRA to her minor child William. William's guardian must withdraw benefits annually from the IRA starting in 2024, the year after Agatha's death, using the pre-SECURE Act life expectancy payout method computed based on the age William will attain on his birthday in 2024. If William reaches the age of majority on August 9, 2029, that is the final year the RMD will be based on the life expectancy payout. William will have to withdraw the rest of the IRA using the 10-year rule, meaning the IRA must be completely distributed to him no later than December 31, 2039, taking an annual RMD during each year of the 10-year period, calculated using William's life expectancy. If William dies after attaining the age of majority but before the end of the 10-year period, his successor beneficiary will have to withdraw the remaining funds in the IRA over what is left of William's 10-year period. If William dies before attaining the age of majority, the 10-year payout to his successor beneficiary will begin the year after William's death.

Only a child of the deceased participant, and not a grandchild or stepchild, will qualify under this exception.

To permit life expectancy distributions for a minor child prior to reaching the age of majority, the child must be the sole designated beneficiary of the plan.

Some uncertainty exists as to when a child will have reached the age of majority. Generally, when a minor reaches the age of majority is a matter of state law. Most states deem an individual to have reached the age of majority upon turning 18. Alabama and Nebraska set the age of majority at age 19, while Mississippi considers an individual a minor until they reach the age of 21. However, the SECURE Act provides a reference to the Code and Treasury Regulations which extends the age of majority "if the child has not completed a specified course of education and is under the age of 26." This could extend the age of majority to the age of 26 if the child is enrolled in college or graduate school.

What are the “disabled individual” and “chronically ill individual” exceptions?

A disabled or chronically ill beneficiary is considered an eligible designated beneficiary and is not subject to the 10-year rule. The life expectancy payout applies to the disabled individual and, upon his or her death, the 10-year rule begins.

A person is considered “disabled” if he or she “is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration.”

Thus, individuals who are only partially disabled or whose disability does not prevent them from engaging in substantially gainful activity would generally not qualify. A person is considered unable to engage in substantial gainful activity if not able to earn more than a certain defined monthly amount.

A person is deemed “chronically ill” if the individual has been certified by a licensed health care practitioner as a person who is unable to perform, without substantial assistance from another individual, at least two activities of daily living for a period of at least 90 days due to loss of functional capacity. The six activities of daily living include eating, toileting, transferring, bathing, dressing and continence. The beneficiary must meet the definition as of the participant’s date of death. Additionally, the licensed health care practitioner must expect the chronic illness to continue for an indefinite and lengthy period of time.

The beneficiary’s status as disabled or chronically ill is determined as of the date of the participant’s death. Thus, an able designated beneficiary who becomes disabled at a later date is not entitled to switch over to a life expectancy payout.

How does the “not more than 10 years younger than the decedent” exception work?

This exception is fairly straightforward. A beneficiary who is not more than 10 years younger than the deceased retirement plan participant can continue to stretch distributions from a plan during the beneficiary’s lifetime without regard to the SECURE Act’s 10-year rule.

The exception permitting a life expectancy payout for a beneficiary who is not more than 10 years younger than the deceased participant ends at the death of the beneficiary.

Beneficiaries who may benefit from this exception include siblings, parents and unmarried partners of the deceased participant.

What happens if an eligible designated beneficiary dies before the 10-year rule expires?

Upon an eligible designated beneficiary's death, the remainder of a participant's retirement plan must be completely distributed within 10 years after the death of the eligible designated beneficiary. Thus, the 10-year rule applies after the death of the eligible designated beneficiary.

For example, if a disabled child of a plan participant is an eligible beneficiary of a parent who dies when the child is age 25 and the child dies at age 35, the beneficiary of the disabled child's remaining beneficiary interest must be distributed by the end of the year of the tenth anniversary of the death of the disabled child.

If a child is an eligible beneficiary based on having not reached the age of majority before the participant's death, the 10-year rule applies beginning with the earlier of the date of the child's death or the date that the child reaches the age of majority. The child's entire interest must be distributed by the end of the tenth year following that date.

What happens if a participant designates a charity or his or her estate as the beneficiary?

If a retirement plan participant designates a charity as a beneficiary of his or her funds in the plan, the charity must withdraw the funds in the plan designated for the charity within five years after the plan participant's death if the participant died before the participant's required beginning date (i.e., the date funds must begin to be distributed from the plan – now age 73). If the participant died on or after the required beginning date, the charity can withdraw the funds over the remaining life expectancy of the participant at the time of the participant's death.

If a deceased retirement plan participant did not designate a beneficiary of his funds in the plan, the funds will be distributed to the estate of the deceased participant and distributed pursuant to the Last Will and Testament of the deceased participant if he had a will or, if he did not have a will, then by the laws of intestacy of the state in which they died.

In that case, if the participant died before the required beginning date, then the beneficiary must withdraw all of the retirement account within five years of the deceased participant's death.

If the participant died after the required beginning date, then the beneficiary's RMD is based on the deceased participant's life expectancy immediately before death.

What happens if a participant designates a trust as the beneficiary?

When a trust is designated as the beneficiary of a retirement plan, the requirements for distributions from the plan vary depending on the type of trust and whether the beneficiary of the trust is an eligible designated beneficiary.

A “conduit trust” is a trust that provides that all distributions from the plan must be distributed immediately to the beneficiary of the trust.

If the retirement plan participant names a conduit trust as the beneficiary of the plan and the beneficiary of the trust is an eligible designated beneficiary, the trust would qualify to take distributions under the rules for eligible designated beneficiaries. For example, if a spouse were the beneficiary of the conduit trust, the trust would qualify to take distributions over the surviving spouse’s life expectancy.

If the beneficiary of the plan is a conduit trust and the beneficiary of the trust is not an eligible designated beneficiary, the 10-year rule would apply and the trust would be required to withdraw all of the funds in the plan no later than the end of the year containing the tenth anniversary of the participant’s death.

An “accumulation trust” is a trust that does not require the immediate distribution of receipts from a retirement plan. The trustee has discretion over whether to distribute assets to the beneficiaries and therefore can accumulate the assets required to be distributed from the plan to the trust.

If the retirement plan participant designates an accumulation trust as the beneficiary of the plan, the trust would not qualify to take distributions under the rules for eligible designated beneficiaries. In that case, all of the assets remaining in the retirement plan would have to be distributed to the trust by the end of the year containing the tenth anniversary of the participant’s death.

I am married and plan to leave my estate to my spouse. How much of my estate will go to taxes?

The law provides for an unlimited marital deduction, meaning the spouse who dies pays no federal or New York State estate taxes if the entire estate is left to a surviving spouse and/or charity. However, when the surviving spouse dies, then the estate may be subject to both state and federal estate taxes.

In those instances where assets are left to beneficiaries other than a surviving spouse and/or charity, federal and/or New York State estate taxes may be due on the decedent's estate. Under federal law, the estate tax is calculated based on the portion of the value of the estate that exceeds the federal estate tax exemption amount. New York State law, on the other hand, provides that once the value of the estate is more than 5% above the New York estate tax exemption amount, the New York State estate tax is calculated on the value of the entire estate and not just the portion of the estate that exceeds the New York State estate tax exemption amount.

What are the laws concerning the federal estate tax?

The Tax Cuts and Jobs Act, which took effect on January 1, 2018 (the "Tax Act") modified the existing laws concerning estate and gift taxes. Significantly, the Tax Act increased the amount that may be exempted from federal estate tax to $11.18 million with the exemption adjusted for inflation annually thereafter. In 2023, the federal estate tax exemption is $12.92 million per person (or $25.84 million for a married couple). The increased exemption is legislated to expire at the end of 2025, at which time the exemption will reduce back down to $5.62 million per person (adjusted for inflation since 2018) unless new legislation is adopted. Notwithstanding the increased exemption amount, the 40% estate tax rate continues to apply to the value of that portion of the estate in excess of the exemption amount.

The Tax Act continues the law of portability. Portability allows a surviving spouse to use any unused portion of the first spouse to die's federal estate tax exemption when the surviving spouse dies (see example of portability on page 14).

Additionally, the Tax Act continues to unify the gift and estate tax exemptions. Thus, the lifetime gift tax exemption in 2023 is also $12.92 million and is indexed for inflation. Notably, unlimited gifts may be made to a spouse or charity without any gift tax consequence just as there is no estate tax assessed on assets passing from a decedent to a spouse or charity. As a result, each person may now make up to $12.92 million of gifts (in addition to the $17,000 per person annual gift exclusion amount) before being subject to tax and may make unlimited gifts to a spouse or charity. It is important to understand, however, that any gift made (other than the tax-exempt gifts made to a spouse or charity) which is greater than $17,000 per person per year will reduce the estate tax exemption for the individual on a dollar-for-dollar basis. Therefore, if a person makes gifts totaling $2 million during his or her lifetime (in excess of the $17,000 per person annual exclusion amount) and the estate tax exemption is still at the time of such person's death equal to $12.92 million, then such person would only have a $10.92 million exemption at death.

However, the advantage of making such a gift is that any appreciation in the value of the gifted assets will occur outside of the individual's taxable estate. Thus, the loss of $2 million of estate exemption may be insignificant if the assets grow to a value of $5 million at the time of the donor's death, as the appreciated value of $3 million takes place outside of the individual's taxable estate and is not subject to estate tax. So, the ability to make larger gifts without paying gift tax up front, combined with the ability to continue to do minority and other discount planning in a low-interest rate environment, may facilitate the transfer of large amounts of wealth to succeeding generations without being subject to gift or estate tax.

What are the laws concerning the New York State estate tax?

In addition to the federal estate tax referenced above, estates of individuals who are residents of New York State at the time of their death may be subject to a separate state estate tax if the decedent's assets pass to someone other than a spouse or to a charitable entity.

Effective April 1, 2014, New York State adopted sweeping changes to its state estate tax law which previously taxed estates passing more than $1 million to non-spousal and non-charitable beneficiaries. Under this legislation, the New York State estate tax exemption amount (referred to as the "exclusion amount" under New York law and so referred to in this publication) incrementally increased over time from April 1, 2014 through December 31, 2018. Since that time, the exclusion amount is currently being adjusted for inflation annually such that in 2023 the exclusion amount is $6.58 million.

Under the existing legislation, estates valued at more than the $6.58 million New York State estate tax exclusion amount will continue to pay a separate New York State estate tax. Significantly, however, for those estates which are valued at more than 5% above the $6.58 million exclusion amount, the New York State estate tax will be calculated based on the full value of the estate, rather than just on the amount exceeding the exclusion amount as had been past practice.

Such calculation, known as the "fiscal cliff", can have a significant adverse impact on taxes due. For example, if an individual died on June 1, 2023, with an estate valued at $6.58 million, the individual would pay no estate tax. However, if that same individual instead died at the same time with an estate valued at $6.909 million (5% or $329,000 over the exclusion amount), the individual would pay nearly $626,352 in New York estate tax. Thus, the heirs of the decedent's estate would be in a better financial position if the estate was valued at only $6.58 million, as they would receive the entire amount for their inheritance. If the estate was valued at $6.909 million, the heirs would only receive $6,282,648 (or $626,352 less than they otherwise would have received).

Based on the above, it is of critical importance that a careful analysis of the value of an estate be conducted so steps can be taken through gifting, disclaimer or other strategies to reduce the New York State estate tax liability.

Are gifts I give while I am alive also taxed?

You can give unlimited separate gifts of $17,000 per year ($34,000 per year for married couples) to as many friends or family members as you would like, without any tax consequences. These gifts are referred to as the annual exclusion amount and are not deemed income to the recipient. However, any income (e.g., interest, dividends) generated by the gifts after transfer are taxed to the recipient.

The Tax Act and subsequent inflation adjustments 1) increased the lifetime gifting amount to a maximum of $12.92 million per person, and 2) imposed a separate federal gift tax on the amount over this gift tax exemption at a rate of 40%. New York State does not impose a separate state gift tax, but instead adds back certain federally taxable gifts made during the three (3) year period preceding the death of the decedent, which may cause additional New York State estate tax to become payable.

Once you give any individual or entity (other than a spouse or charity) more than $17,000 ($34,000 for a married couple) in any one year, you are obligated to file a federal gift tax return

for such taxable gifts. In addition, there is an interplay between the gift and estate tax laws: any amounts gifted over $17,000 ($34,000 for married couples) reduces the lifetime estate tax exemption amount of the maker of the gift on a dollar-for-dollar basis. For example, if you give an individual $20,000 in 2023, your $12.92 million lifetime federal estate tax exemption in that year would be reduced by the $3,000 excess over $17,000 to $12.917 million.

If the excess gifts ever totaled more than the $12.92 million lifetime federal gift tax exemption amount in 2023, an upfront federal gift tax would have to be paid at a rate of 40% on such excess. In addition, an estate tax would be paid on the decedent's estate to the extent the value of decedent's estate exceeds the estate tax exemption amount in the year of the decedent's death – as reduced by the amount of gifts made over the annual exclusion amount during the decedent's lifetime.

New York State abolished its gift tax as of 2000, however, the newer legislation has resulted in adding to the taxable estates of its decedents (dying between April 1, 2014 and December 31, 2025) the value of all taxable gifts made during the three (3) year period preceding death. This "add-back" provision also applies to gifts of real estate and tangible personal property located in New York State.

What can I do to reduce taxes due on my estate?

As an individual

If your estate exceeds the then prevailing federal or New York State estate tax exemption, you can act during your lifetime to reduce the value of your estate by making tax-free gifts of $17,000 per year ($34,000 for a married couple) to as many friends or family members as you would like. Larger gifts may be contemplated, particularly of assets likely to appreciate, so the appreciation occurs outside of your taxable estate. In addition, you may want to consider gifting larger amounts (not to exceed the $12.92 million lifetime federal gift tax exemption, as a gift of that magnitude would cause an immediate federal gift tax to be due). The gifting of such amounts will not result in the imposition of gift tax and may lower your overall estate tax liability of your death (although special consideration must be given to those gifts made within three (3) years of their death as discussed in the prior section.)

There are other estate tax reduction strategies as well – such as the use of Irrevocable Life Insurance Trusts (ILITs), Qualified Personal Residence Trusts (QPRTs), Grantor Retained Annuity Trust (GRATs) and/or other discount planning – which may be applicable, but are beyond the scope of this publication and should be explored with a skilled estate planning attorney or tax advisor.

As a married couple

In 2022, a married couple is able to take advantage of the $12.92 million per person federal exemption amount and exempt up to $25.84 million over their joint lifetimes by implementing proper estate planning.

One important planning strategy that continues to be viable under the new Tax Act is “portability.” Please note that portability is only permitted under federal law and is not permitted for New York resident decedents.

Portability is a concept that allows the executor of a deceased spouse’s estate to transfer any unused portion of the current $12.92 million federal estate tax exemption to the surviving spouse. Thus, if in 2023 the first spouse to die had an estate of $10.92 million which was bequeathed to the couple’s children, then the unused portion of such predeceased spouse’s $12.92 million estate tax exemption (i.e., $2 million) could be “ported over” to the surviving spouse. This would allow the surviving spouse to have a $14.92 million estate tax exemption at the time of his or her subsequent death, consisting of the surviving spouse’s $12.92 million exemption plus the $2 million unused portion of the predeceased spouse’s estate tax exemption. So, $25.84 million passes to the next generation estate tax-free as a result of the fact that $10.92 million of the estate tax exemption was used up by the estate of the first spouse to die, and the remaining $14.92 million was used up by the surviving spouse’s estate.

For portability to be effective, the executor of the estate of the first spouse to die must make an affirmative election on the estate tax return of the predeceased spouse (which must be filed within nine months of such spouse’s death) transferring to the surviving spouse the unused portion of the predeceased spouse’s estate federal tax exemption. Filing of the portability election can become very important in spousal cases even if the first spouse to die has a very modest net worth. The surviving spouse will want to ensure that the unused portion of the predeceased spouse’s exemption is transferred to the surviving spouse in order to exempt as much of the value of the surviving spouse’s estate as possible from estate taxation.

To maximize the use of the New York State estate tax exemption (since portability is only recognized for federal and not New York State estate tax purposes), and to plan for any future federal tax changes that may eliminate large exemptions and portability, married individuals may elect to incorporate a Credit Shelter Trust in their wills so they can exempt two times the estate tax exemption amount from estate taxation (currently $25.84 million for federal estate tax purposes or $13.16 million for New York State estate tax purposes in 2023).

Because portability is not available in New York, leaving assets directly to one’s spouse outright will still result in there being no estate tax at the time of the death of the first spouse but all of the assets left to the surviving spouse will become part of the surviving spouse’s estate and will

be subject to applicable estate taxes upon that spouse's subsequent death. If a Credit Shelter Trust is established, the assets of the first spouse to die may be deposited into that trust and still be exempt from the payment of federal estate taxes at the time of the surviving spouse's death.

Additionally, even with the federal estate tax, where portability is still available, Credit Shelter Trusts may be useful to avoid having assets go directly to the surviving spouse where such assets may be subject to the claims of the surviving spouse's creditors or the uncertainties of remarriage.

The use of a Credit Shelter Trust in a will effectively allows a husband and wife to collectively shelter up to $25.84 million of their assets from federal estate taxes and $13.16 million from New York State estate taxes (i.e., two times the $12.92 million federal exemption or two times the $6.58 million New York State exemption amount which exist in 2023). This sheltering occurs since:

1. At the time of the death of the first spouse, the surviving spouse can decide not to accept up to the first $6.58 million of the assets of the deceased spouse for New York State estate tax purposes or $12.92 million for federal estate tax purposes in 2023, and instead have such assets fall into a Credit Shelter Trust exempt from tax both in the estates of the deceased spouse and the surviving spouse, and thereafter; and
2. The surviving spouse's own personal exemption removes the second sum of $6.58 million or $12.92 million from his or her taxable estate.

A Credit Shelter Trust may provide for all income from the trust's assets to be paid to the surviving spouse during his or her lifetime. The trust principal may also be made available for direct withdrawal by the surviving spouse (in annual amounts not to exceed 5% of the trust principal) if the surviving spouse so elects, or if larger amounts are needed. These additional amounts may be withdrawn by the surviving spouse for his or her health, education, maintenance or support as the surviving spouse determines, or may be distributed to the surviving spouse for other purposes, within the sole discretion of an independent trustee. Upon the death of the surviving spouse, the trust principal (i.e., the exemption amount of assets contained in the trust and all appreciated value of such assets) pass to the trust's beneficiaries (e.g., children, other individuals) estate tax free.

To maximize flexibility and allow for consideration of future income tax or other considerations, a will can also provide for a type of Credit Shelter Trust which only becomes funded at the option of the surviving spouse. Such a Credit Shelter Trust is referred to as a Disclaimer Credit Shelter Trust and may be an appropriate estate planning strategy which a married couple may want to discuss with a skilled estate planning attorney or tax consultant.

A Disclaimer Credit Shelter Trust can be particularly attractive as it allows for decisions to be made at the time of the first spouse's death as to whether to renounce or disclaim into the Credit Shelter Trust based on the status of the estate tax laws and the family's financial circumstances prevailing at that time. Please note, pursuant to the Internal Revenue Code, such decision to disclaim must be made within nine months of the death of the first spouse. Significantly, the nine-month disclaimer period cannot be extended for any reason, and the failure to act within this period will result in the assets being considered part of the surviving spouse's taxable estate.