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Estate Planning for Retirement Plans after SECURE Act

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ESTATE PLANNING FOR RETIREMENT PLANS AFTER SECURE ACT

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ESTATE PLANNING FOR RETIREMENT PLANS AFTER SECURE ACT

By Steven E. Trytten, Esq., CPA, MBA

I. The "Trytten Financial Model" Case Studies – Methodology.

This section provides background on the philosophy and design of the "Trytten Financial Model." Dozens of case studies were run using this model during the period 2003 – 2010 and are identified as such. They are included in these materials as they are still relevant in understanding the economics of different planning strategies.

Additional case studies were run in 2020 to further develop understanding of the economics of different planning strategies under the new RMD rules added by the SECURE Act.[1]

The case studies run in 2010 reflect the tax law in effect on December 1, 2010 with respect to income tax, transfer tax, and RMD Rules. Specifically, the general income, estate, gift and generation-skipping tax rates, *etc.*, were calculated with the assumption that the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") would sunset and that pre-EGTRRA law would return.

The case studies run in 2020 reflect the tax law in effect on August 1, 2020 with respect to income tax, transfer tax, and RMD Rules. Specifically, it is assumed that the temporary provisions of the Tax Act of 2017 will sunset as scheduled, generally on December 31, 2025.

A. How "Success" Is Defined In Financial Model – "After-Tax Assets."

It is impossible to evaluate the results of a Case Study without a benchmark of comparison, *i.e.*, a definition of "success." It is too easy to define success as minimizing taxes (and, prior to the Tax Reform Act of 1997, minimizing the excise tax on excess retirement plan accumulations, which carried the stigma of a penalty). Minimizing taxes does not always produce the best outcome. What most clients really want is to maximize the net worth that remains after taxes have been paid ("After-Tax Assets"). If a client wants to preserve the maximum After-Tax Assets for future generations, the transfer taxes (gift, estate, and generation skipping taxes) must be included in the equation. On the other hand, if a client's primary concern is her own financial security during retirement, the best definition of success may be one that takes only the client's lifetime income taxes into account. It is essential to discuss these issues with the client and reach a consensus in defining "success" for purposes of the client's distribution planning.

Either way, it is difficult to compare what is left for the client's family when different distribution strategies produce different amounts of retirement plan and "after-tax" assets over varying time horizons. Other commentators have struggled with this issue and reached surprisingly different conclusions, depending on how they chose to compare the apples to the oranges.

There is a way to compare retirement plan assets to "after-tax" assets on a true "apples to apples" basis, and this approach produces the most objective evaluation of different distribution strategies. This method of comparison involves an analysis for each distribution strategy that

[1] The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, Pub. L. 116–94, was signed into law by President Donald Trump on December 20, 2019, as part of the Further Consolidated Appropriations Act, 2020 (2020 United States federal budget).

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forecasts the gradual payout of a retirement plan over the entire deferral period in a way that shows the total accumulation of after-tax net worth ("After-Tax Assets") at the end of the deferral period. The distribution strategy that produces the largest amount of After-Tax Assets at the end of the deferral period wins!

Prior to the SECURE Act, when a DB was designated the deferral period was the Participant's lifetime plus a period consisting of the DB's single life expectancy. SECURE Act adds a number of variations. Now, when an Eligible Designated Beneficiary ("EDB") is designated, the deferral period is the Participant's lifetime plus an EDB's lifetime plus 10 years.

"After-Tax Assets" is the measure of success in the extensive Excel spreadsheets your author built to produce these Case Studies. This particular measure of success includes transfer taxes, which is appropriate if the client's primary goal is to maximize the size of the Beneficiary's After-Tax Assets. The point in time that is used for comparing After-Tax Assets of various strategies is generally the end of the longest deferral period that arises in connection with each strategy. The After-Tax Assets the beneficiaries have accumulated by then under each of the different distribution strategies can be compared on an "apples to apples" basis. Relative percentages are shown for convenience, with the "100%" being arbitrarily assigned to the distribution strategy involving full distribution of the plan in the earliest year.

However, your author decided *not* to recognize capital gains tax on the beneficiary's non-retirement appreciated securities, on the theory that these securities would likely receive a cost basis "step up" at the beneficiary's death under current law.

B. How The Numbers Were Run; What The Numbers Represent.

The results of each Case Study were generated with a financial model in Excel with separate spreadsheets corresponding to each planning scenario. In addition, an extra scenario runs in the background to measure how big the Beneficiary's After-Tax Assets would have been had there not been a retirement plan at all. From a statistical point of view, this extra scenario serves as the "control" and provides a basis of comparison for the other scenarios.[2]

C. "After-Tax Assets" Defined.

The results shown for each scenario are isolated to show *only the additional portion of the beneficiary's After-Tax Assets that corresponds to the distributions received over the deferral period from the retirement plan ("Additional After-Tax Assets")*. However, all of the calculations (such as tax brackets, *etc.*) reflect the full amount of assets and income corresponding to each scenario.

D. Client's Investment Style.

The distribution planner must understand the client's investment style. Higher yields magnify the differences between distribution strategies. The relative yields inside and outside the retirement plan also impact the financial analysis.

For example, a real estate developer may know how to earn 25% on his money, but the investments may not be permissible inside his retirement plan. In that situation, he may do better investing outside his plan than investing in his plan, and long-term deferral strategies may not be appropriate for him.

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[2] The backup calculations for each scenario fill fifteen or more pages using a 6 point font. The backup calculations for a seven scenario Case Study fill 120 or more pages (seven scenarios plus the "control" scenario). The backup calculations for a seven scenario Case Study run at three different dates of death fills 360 or more pages.

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