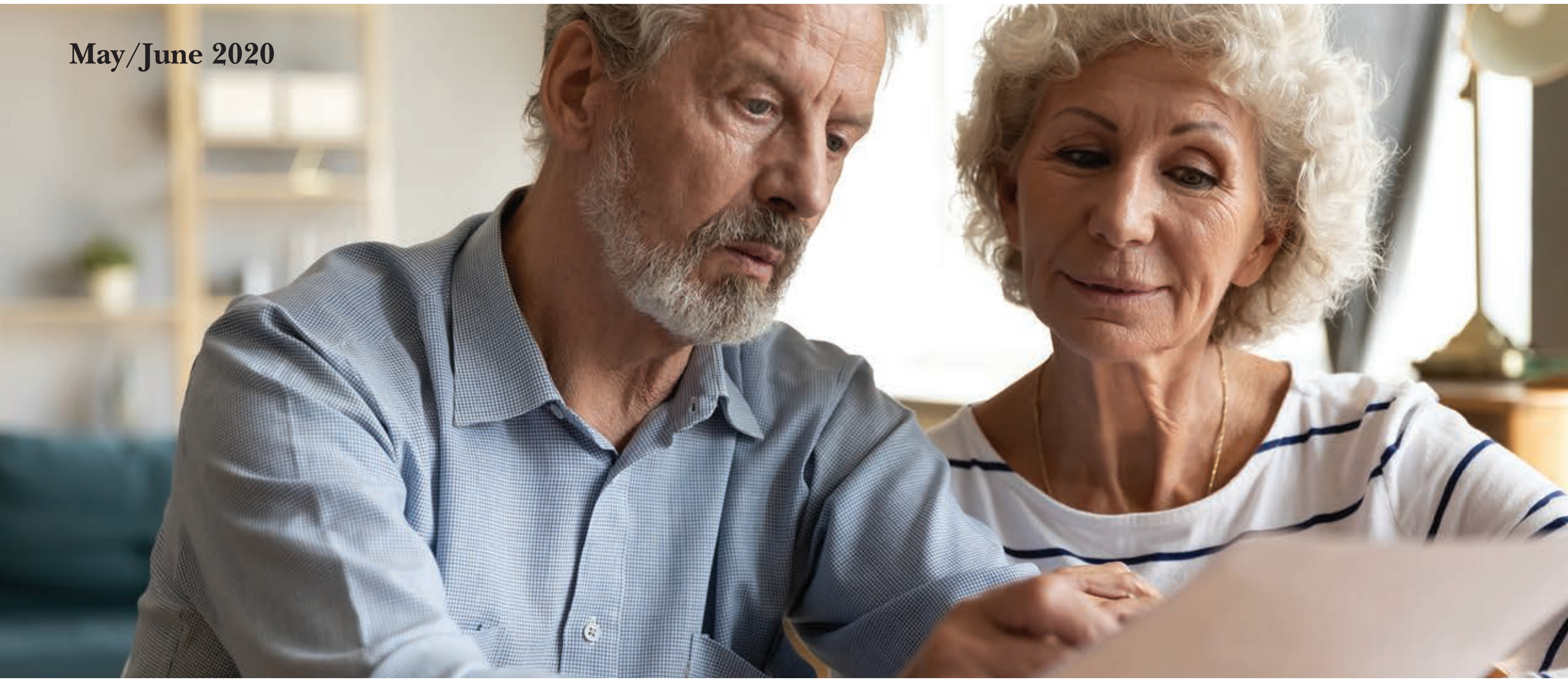
Tax Impact

May/June 2020



The SECURE Act
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Tax Tips

The SECURE Act

Understand the retirement and estate planning implications

If you have significant savings set aside in an IRA, 401(k) plan or similar account, your biggest current concern might be the impact of stock market volatility caused by the COVID-19 pandemic on your retirement account. But you also need to be aware of the Setting Every Community Up for Retirement Enhancement (SECURE) Act. It also could impact your retirement and estate planning strategies. Signed into law in December 2019, the act changes the rules about contributions to and distributions from these plans, as well as the tax impact on those who inherit them. Let's take a closer look at the highlights of the SECURE Act.

Required minimum distributions

Previous law: People with traditional IRAs or non-Roth 401(k) plan accounts had to begin required minimum distributions (RMDs) no later than April 1 of the year following the year in which they reached age 70½. If your 70th birthday was June 1, 2019, for example, you had to take your first RMD by April 1, 2020.

New law: The SECURE Act delays the RMD start date to April 1 of the year following the year in which a person reaches age 72, allowing an additional year or two of tax-deferred growth.

Effective date: This change applies to people who turn 70½ after December 31, 2019. In other words, if your 70th birthday was before July 1, 2019, the old rules still apply. If you turned 70 on July 1, 2019, or later, you can take advantage of the later RMD start date.

Planning considerations: If you reached or will reach age 70½ in 2020, you may previously have planned to take an RMD this year. Talk to your advisor about changing your withdrawal schedule to take advantage of the later start date.

IRA contributions

Previous law: Contributions to a traditional IRA weren't permitted past age 70½. Roth IRA contributions, on the other hand, were permissible at any age so long as the other requirements were met.

New law: The SECURE Act lifts the age restriction on contributing to a traditional IRA. Now, people who continue to work can contribute to their traditional IRAs regardless of age, so long as the other requirements are met. Keep in mind that, even though a contribution may be permitted, it may not be deductible.

Effective date: Tax years beginning after December 31, 2019.

Planning considerations: If you're 70½ or older and still employed, consider including IRA contributions as part of your retirement savings strategy.

Part-time employment

Previous law: Generally, employees who worked less than 1,000 hours per year were ineligible for their companies' 401(k) plans.

New law: Employers with 401(k) plans (except for certain collectively bargained plans) are required to allow qualifying long-term, part-time employees to participate. To qualify, an employee must 1) meet the plan's normal eligibility requirements, 2) have completed at least three consecutive 12-month periods of employment, and 3) have been credited with at least 500 hours of service in each of those periods.

Effective date: This change applies to plan years beginning after December 31, 2020. In addition, employers need not count 12-month periods beginning before January 1, 2021, in determining eligibility. That means employers won't be required to allow part-time employees to participate until 2024.

Planning considerations: If you work part-time, or are considering doing so in the future, assess the impact of this change on your retirement planning strategies.

Inherited IRAs

Previous law: Spouses who inherited an IRA or 401(k) plan could roll the funds into an IRA in their own name and allow the funds to continue growing on a tax-deferred basis until they begin taking RMDs. Nonspousal beneficiaries were able to place the funds in an "inherited IRA" and stretch RMDs over their life expectancies.

New law: In one of its few changes that don't benefit taxpayers, the SECURE Act eliminates so-called "stretch IRAs." Now, nonspousal beneficiaries of traditional IRAs or non-Roth 401(k)s must withdraw the funds within 10 years (with exceptions for certain minor children, disabled or chronically ill beneficiaries, or beneficiaries who are less than 10 years younger than the donor). The act didn't change the treatment of spousal beneficiaries.

Effective date: Distributions with respect to account owners who die after December 31, 2019.

Planning considerations: Account owners with nonspousal beneficiaries (including beneficiaries of certain trusts that hold IRAs) should assess the tax impact of an accelerated distribution schedule on their heirs, and determine whether any other strategies could soften the tax blow and help them meet other objectives as well.

Impact of SECURE Act on employers

If you're a business owner, the Setting Every Community Up for Retirement Enhancement (SECURE) Act includes several provisions that make it easier to offer qualified retirement plans for yourself and your employees. The most significant change is the creation of "pooled employer plans" (PEPs).

PEPs are multiple employer plans (MEPs) available to unrelated employers, allowing them to take advantage of economies of scale to reduce the cost of employer-provided retirement plans. Previously, MEPs weren't a viable option for many businesses because 1) they required participating employers to have a "commonality of interest," such as a common industry or geographic area, and 2) they were subject to a "one bad apple" rule, under which one participating employer's compliance failure jeopardized the entire plan.

The SECURE Act eliminates these requirements, beginning in 2021, making the benefits of MEPs available to far more employers. PEPs will be sponsored by financial services companies, insurance companies and other providers. The act also increases certain tax credits available to businesses that maintain qualified retirement plans.

Consult your advisor

In light of these and other changes made by the SECURE Act, it's a good idea to consult your advisor to evaluate the act's impact and revisit (and revise if necessary) your retirement and estate planning plans. ■

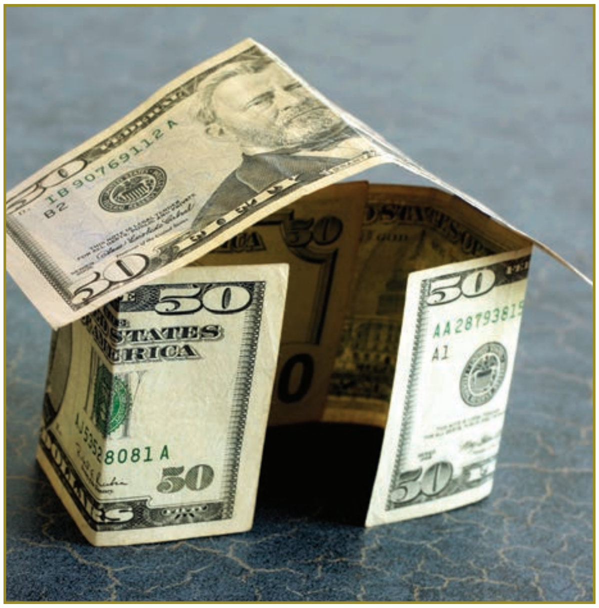
Is your business a tax shelter?

Most people, when they hear the term "tax shelter," imagine a tax-avoidance scheme of questionable legality. But while some tax shelters operate in legal grey areas, more often than not they involve legitimate tax-saving strategies. Perhaps more surprising, however, is that many ordinary businesses meet the broad definition of a tax shelter, a classification that can have negative tax consequences.

Why it matters

Historically, small businesses have enjoyed certain tax advantages, and these advantages were enhanced by the Tax Cuts and Jobs Act (TCJA). The TCJA increased the three-year average gross receipts threshold for qualification as a small business to $25 million. Benefits of small-business status include:

- Eligibility to use the cash method of accounting,
- Avoidance of complex, costly inventory accounting requirements,



- Relief from the uniform capitalization rules,
- Ability to use the completed contract method to defer income from certain long-term contracts, and
- Exemption from the TCJA's limits on the deduction of business interest expense.

Even if a business has $25 million or less in gross receipts, it will not qualify for these benefits if it's deemed a tax shelter.

The rules on tax shelters in the Internal Revenue Code and IRS regulations are complex and, in some cases, unclear.

Tax shelter defined

The rules on tax shelters in the Internal Revenue Code and IRS regulations are complex and, in some cases, unclear. In general, tax shelters include:

- Entities formed with a significant purpose of avoiding or evading federal income taxes,
- Enterprises (other than C corporations) if interests in them have been offered for sale in offerings required to be registered with federal or state securities regulators, and
- Syndicates.

The definition of "syndicate" is broad enough to include many ordinary businesses. A syndicate is simply an entity, other than a C corporation, for which more than 35% of its losses during the tax year are allocable to limited partners or "limited entrepreneurs." A limited entrepreneur is an owner (other than a limited partner) who doesn't actively participate in management of the entity.

For purposes of determining the allocation of losses, limited partners and limited entrepreneurs don't include 1) persons who actively participate in management, 2) certain family members of active participants, 3) persons who previously actively participated in management for at least five years, 4) the estates of active participants or certain family members, and 5) persons deemed to be active participants under IRS regulations.

Planning opportunities

The consequences to a small business of being deemed a tax shelter are significant, including the loss of the tax benefits listed above. Fortunately, there may be planning strategies businesses can use to avoid these consequences.

Technically speaking, an entity is a syndicate (and, therefore, a tax shelter) if more than 35% of its losses are *allocable* to limited partners or limited entrepreneurs. But the IRS, in certain rulings and regulations, appears to have interpreted the term *allocable* as allocated. This suggests that an entity may be able to avoid being classified as a syndicate if the owners agree to reduce the amount of losses *allocated* to those who don't actively participate in management.

Another potential strategy is to have inactive owners increase their level of participation in management to avoid being classified as limited partners or limited entrepreneurs.

Protect your business

If your business otherwise qualifies for small business tax benefits, it's critical to determine whether your business is a tax shelter. If it is, talk to your advisor about strategies for avoiding that classification. ■

An estate plan benefits you and your family

Quick question: Who needs an estate plan? The answer isn't only the affluent; it's everyone. While gift and estate tax liability isn't an issue for most folks, most families can benefit from a comprehensive plan that divides their wealth, protects their well-being and provides a compass for the future.

Asset distribution

Estate planning is often associated with the division of assets, and this is certainly a key component. It's typically accomplished, for the most part, by drafting a will, which is the foundation of an estate plan.

With a valid will, you determine who gets what, where, when and how. It can cover everything from the securities in your portfolio to personal property, such as cars, artwork or other family heirlooms.

In contrast, if you die without a will — referred to as dying "intestate" — state law will control the disposition of your assets. This may result in unintended consequences. For example, children from a prior marriage may be excluded if state law dictates that all assets are to go to a surviving spouse.

In addition, you'll need to name the executor of your estate. He or she will be responsible for

carrying out your wishes according to your will. Your executor may be a professional, a family member or a friend. Also, designate a successor in case your first choice is unable to handle the duties.

Probate defined

If your estate plan includes only a will, your estate will most likely have to go through probate. Probate is a court-supervised process to protect the rights of creditors and beneficiaries and to ensure the orderly and timely transfer of assets. The complexity and duration of probate depends on the size of your estate and state law.

The power of a power of attorney

An estate plan also can help ensure that your long-term health care is handled in the way that you wish. Notably, you can create a health care power of attorney. It grants another person — for example, a family member or a friend — to act on your behalf in the event you're incapacitated. A power of attorney may be coordinated with a living will specifying your wishes in end-of-life situations and other health care directives.

Putting your wishes in writing

Finally, an estate plan can accomplish a variety of other objectives, depending on your preferences and circumstances. If you have minor children, name a guardian in your will in the event of your premature death. Without such a provision, the courts will appoint a guardian that may not be the one you would choose.

Your estate plan can also protect against creditors, primarily through trusts designed for these purposes. Accordingly, while trusts were often seen mainly as tax-saving devices in the past, they can fulfill a multitude of other roles.

With a valid will, you determine who gets what, where, when and how.

There is one last document that ties up some loose ends. Although a "letter of instructions" isn't legally binding, it can express your wishes about numerous matters ranging from burial arrangements to the religious upbringing of children. It may also provide an inventory of your assets and their location.

Now is the time to act

The benefits of having an estate plan are clear, so what are you waiting for? Contact your attorney or estate planning advisor sooner rather than later to learn additional details. ■

Tax Tips

Take advantage of the temporary gift tax break

The Tax Cuts and Jobs Act temporarily doubled the federal gift and estate tax exemption through 2025. Adjusted for inflation, the exemption currently allows an individual to transfer up to $11.58 million free of federal gift or estate tax. Married couples can shield up to $23.16 million from those taxes. These sizable exemption amounts create an attractive opportunity to minimize taxes on your wealth by gifting business interests or other assets to family members before they drop to their previous levels of $5 million and $10 million, respectively (adjusted for inflation) on January 1, 2026.

Some affluent families have been reluctant to take advantage of this opportunity for fear of a "clawback." In other words, there was a risk that a portion of their pre-2026 gifts may be clawed back and subject to estate taxes if the exemption amount is lower when they die. Although Congress didn't appear to intend such a result, a literal reading of the tax code suggested that previous gifts could be added back into one's estate and subject to tax based on the exemption amount in effect in the year of death. Fortunately, IRS regulations finalized in November 2019 provide assurances that this won't happen. ■

Time for a cost segregation study?

Is your business planning to acquire, construct or substantially improve a building? Did it do so during the last several years? If so, consider a cost segregation study. These studies identify building costs that are properly allocable to tangible personal property rather than real property. And this allows your business to accelerate depreciation deductions, reduce taxes and boost cash flow. Cost segregation studies are particularly valuable now, because they can enhance the benefits of bonus depreciation, which allows you to immediately deduct 100% of the cost of qualifying assets placed in service after September 27, 2017, and before January 1, 2023. (After 2022, bonus depreciation will be phased out over four years.) ■

Watch out for audit red flags

The chances of being audited by the IRS have been shrinking in recent years, down to only 0.45% for the 2019 fiscal year. But there are several red flags that can increase the probability of IRS scrutiny. Examples include filing Schedule C for a business (especially if it includes significant income or large home office deductions), taking higher-than-average deductions, claiming significant rental losses, writing off "hobby" losses, claiming 100% business use of a vehicle, and taking large deductions for business meals and travel. ■