ED SLOTT'S IRA ADVISOR

December 2020

Tax & Estate Planning for Your Retirement Savings

WHAT'S INSIDE?

Happy Holidays

Three Years, Three Rules: *The New RMD Requirements*

The initials "RMD" normally stand for "required minimum distribution," but maybe it should instead stand for "really made difficult." The combined effect of several recent tax-law changes (the CARES Act waiver of 2020 RMDs, the delayed effective date of the new life expectancy tables, and the SECURE Act increase of the starting RMD age to age 72) will make it challenging for individuals to keep track of the RMD rules over the next few years.

IRS Finalizes New RMD Tables Effective for 2022

On November 6, 2020, the IRS released final regulations with new life expectancy tables for calculating RMDs from IRA and company retirement savings plans. The new life expectancy tables will result in somewhat smaller RMDs. However, they cannot be used until 2022.

The IRS revised the current tables, in effect since 2002, to reflect longer life expectancies. In November 2019, the IRS issued proposed regulations that were intended to become effective for 2021 RMDs. However, because the final regulations were issued so late in 2020, the IRS delayed the effective date to allow custodians and record keepers additional time to implement their systems.

All three RMD life expectancy tables were revised:

1. The Uniform Lifetime Table, which is used to calculate lifetime RMDs.
2. The Joint (and Last Survivor) Life Expectancy Table, which is used instead of the Uniform Lifetime Table when a spouse is the sole IRA or plan beneficiary and is more than 10 years younger than the IRA owner or plan participant.
3. The Single Life Expectancy Table, which, under the SECURE Act, is used only to calculate post-death RMDs for "eligible designated beneficiaries" (i.e., surviving spouse, minor child of the account owner/participant, chronically ill or disabled individual, or someone no more than 10 years younger than the owner/participant). All other beneficiaries who inherit after 2019 use the 10-year payout rule. *Note: The Single Life Expectancy Table is also used if an IRA owner dies after the required beginning date (April 1 of the year following the year that the IRA owner turns age 72) without naming a living beneficiary.*

The new tables may also be used to calculate 72(t) periodic payments, starting in 2022.

The final regulations and new life expectancy tables can be viewed at public-inspection.federalregister.gov/2020-24723.pdf.

Executive Summary

Three Years, Three Rules: *The New RMD Requirements*

- There are now three different RMD rules for 2020, 2021 and 2022: 1) For 2020, RMDs were waived by the CARES Act; 2) For 2021, RMDs will once again be due and will be calculated using the existing life expectancy tables; 3) For 2022, new life expectancy tables will apply.
- On November 6, 2020, the IRS released final regulations with revisions to all three life expectancy tables, resulting in somewhat smaller RMDs beginning in 2022.
- Non-spouse beneficiaries who inherit before January 1, 2022 will be required to reset their 2022 RMD.
- For those who have an RBD of April 1, 2022, it is imperative they use the existing Uniform Lifetime Table for the 2021 RMD (even if delayed into 2022) and the new Uniform Lifetime Table for the 2022 RMD.

State Tax Implications of Roth Conversions

- The best time to do a Roth conversion is late in the year, when precise planning is most likely.
- One often overlooked factor is the state tax effect on Roth conversions. Possible implications are twofold: those regarding state income taxes, as well as those regarding state estate or inheritance taxes.
- Some states have no income taxes, some states do, and some states have income taxes plus special rules.
- From a state income tax perspective, it is suggested a person wait for a Roth conversion until after a move to a state with lower (or no) state taxes, and vice versa.
- The general framework for each state's estate tax system is similar: there is an exemption amount and a graduated tax rate on any excess assets, which increases with the value of the taxable estate.

RMD Rules for 2020, 2021 and 2022

The confusing result of the new laws (and subsequent IRS guidance) is that there are now three different RMD rules for 2020, 2021 and 2022.

For **2020**, RMDs were waived by the CARES Act. The waiver applies to lifetime RMDs from traditional IRAs, SEP and SIMPLE IRAs and company savings plans, like a 401(k) (but not defined benefit plans). It also applies to RMDs for beneficiaries of traditional IRAs, Roth IRAs and company plans. And, it allows participants who postponed their first RMD from 2019 into 2020 to forgo both the 2019 and 2020 RMDs.

For **2021**, RMDs will once again be due and will be calculated using the existing life expectancy tables.

RMDs for 2021 are calculated as if the 2020 waiver had not occurred. This means that no make-up 2020 RMDs are required for 2021. It also means that, in using the Single Life Expectancy Table, nonspouse beneficiaries will calculate their 2021 life expectancy factor by subtracting 2 years from their 2019 factor.

Example 1: Dimitri is subject to RMDs from his SEP IRA. His 2020 RMD was waived by the CARES Act. In 2021 when he is age 75, Dimitri will be required to take an RMD based on a 22.9-year life expectancy factor from the current Uniform Lifetime Table.

If his SEP IRA is worth $300,000 on December 31, 2020, the 2021 RMD will be $13,100 ($300,000/22.9). Dimitri will not be required to make up the waived 2020 RMD.

Example 2: Abigail inherited an IRA from her mother in 2017 at age 35. Abigail was required to take her first RMD from the inherited IRA by December 31, 2018. Since she turned age 36 in 2018, her 2018 RMD was calculated using 47.5 years, the life expectancy factor for a 36-year old under the existing Single Life Expectancy Table. For each succeeding year, Abigail must subtract 1 from the preceding year's factor. So, her 2019 RMD was based on a 46.5-year life expectancy factor.

Abigail's 2020 RMD was waived. In 2021, Abigail will subtract 2 years from the 2019 factor and use a 44.5-year factor (as if the 2020 RMD had not been waived).

For **2022**, new life expectancy tables will apply. For *lifetime* RMDs, no adjustment in 2022 will be required to account for the fact that pre-2022 RMDs were calculated using the existing Uniform Lifetime Table.

However, nonspouse beneficiaries who inherit before January 1, 2022 will be required to reset their 2022 RMD. These beneficiaries will not simply use the new Single Life Expectancy Table in 2022 at their age in 2022. Instead, they must look to the new Single Life Expectancy Table to determine what their life expectancy factor would have been for their first RMD under that table.

Then, they must subtract 1 year for each succeeding year to arrive at their 2022 life expectancy factor. Although the reset is more complicated than simply applying the new table, it does produce a smaller RMD.

Example 3: Sam's father died in 2018 and left him an IRA. For his first required distribution in 2019 (when he turned age 57), Sam used a 27.9-year life expectancy factor under the existing Single Life Expectancy Table. Sam's 2020 RMD is waived, and his 2021 RMD is calculated using a 25.9-year factor (27.9 - 2).

In 2022, Sam turns age 60. Under the new Single Life Expectancy Table, the life expectancy factor for a 60-year-old is 27.1. However, Sam will not use that factor.

Instead, he will reset his 2022 RMD by determining what his life expectancy factor would have been in 2019 (at age 57) under the new table. That factor is 29.8. Sam then subtracts 3 years (for 2020, 2021 and 2022) from that factor to produce a 26.8-year factor for his 2022 RMD.

First RMD Age Changed to 72

Complicating things further, the SECURE Act increased the age for the first RMD from age 70½ to age 72 for IRA owners who attained age 70½ after 2019. This means the required beginning date (RBD) for them is April 1 of the year following the year they turn age 72. However, workplace plan participants who do not own more than 5% of the company can use the "still-working exception" to defer RMDs until they retire — *if the plan allows it.*

One interesting quirk of this change is that it is impossible for anyone to have an RBD in 2021.

Why? An IRA owner who obtained age 70½ in 2020 falls under the SECURE Act rule allowing RMDs to be delayed until age 72. Thus, the earliest RBD would be April 1, 2022. Anyone who turned age 70½ before 2020 would already be taking RMDs and would have an RBD of April 1, 2020 or earlier.

Additionally, because of the CARES Act RMD waiver, a plan participant taking advantage of the "still-working exception" who would technically have an RBD in 2021 if she retired in 2020, will not have a 2020 RMD.

Be careful! For those individuals who have an RBD of April 1, 2022, it is imperative they use the existing Uniform Lifetime Table for the 2021 RMD (even if delayed into 2022) and the new Uniform Lifetime Table for the 2022 RMD.

Example 4: Minh turned age 70 on October 1, 2019. Since she reached age 70½ after 2019, she falls under the SECURE Act's RMD age rule. Thus, her first RMD year is 2021 (the year she turns age 72), and her RBD is April 1, 2022. Minh must use the existing Uniform Lifetime Table to calculate her 2021 RMD — *even if she delays it to 2022* — and the new table for her 2022 RMD.

Complicating things further, the SECURE Act increased the age for the first RMD from age 70½ to age 72 for IRA owners who attained age 70½ after 2019.

Conclusion

Failing to take an RMD results in a 50% penalty, although the IRS will often waive the penalty if proper steps are taken. (See the April 2019 issue of *Ed Slott's IRA Advisor*.) The combination of the CARES Act 2020 RMD waiver, the new life expectancy tables, and the SECURE Act's age-72 RMD rule will require a high attention to detail to ensure individuals comply with these "really made difficult" requirements. ■

State Tax Implications of Roth Conversions

Guest IRA Experts

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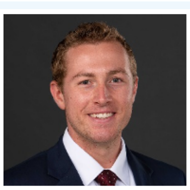

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Roth conversions have been a hot topic in recent years. The relatively low federal income tax rates now in effect can make conversions less taxing.

Moreover, the SECURE Act's requirement that most non-spouse beneficiaries must fully distribute their inherited IRAs within a 10-year time frame reduces the multi-generational appeal of pre-tax accounts, spurring Roth conversions. A provision of the 2017 Tax Cuts and Jobs Act ended the opportunity to undo Roth conversions, so the best time to do them is late in the year, when precise planning is most likely.

All that said, one often overlooked factor is the state tax effect on Roth conversions. From our nationwide experience, the possible state tax implications are twofold: those regarding state income taxes, as well as those regarding state estate or inheritance taxes. *(This discussion covers Roth IRA conversions but the information* *here may apply to other types of Roth accounts.)*

Impact of Income Taxes

For income tax purposes, we group states into three categories: states with no income taxes, states with income taxes, and states with income taxes plus special rules. Those special rules can make a meaningful difference, especially if a client is thinking about moving to another state.

> Those special rules can make a meaningful difference, especially if a client is thinking about moving to another state.

Example 1: Ava is a Florida resident, facing no state income taxes. Her advisor needn't be concerned about state tax on a Roth conversion if she has no relocation plans.

Example 2: Ben lives in North Carolina and plans to stay there. He'll face a 5.25% state income tax, regardless of when he converts his IRA to a Roth.

Tempting Tax Breaks

There are 13 states with special rules for attracting retirees or enticing them to move there, including 12 with exclusions for IRA income. If clients either live in or are thinking of moving to one of these states, advisors should point out how Roth conversions will be affected.

Example 3: Carol lives in Pennsylvania, which has an unlimited exclusion for all retirement plan income, including IRA distributions, with no age limit. Carol may be well advised to execute her Roth conversion or partial conversions before any move to another state.

Not every state with special rules for retirement income is as generous as Pennsylvania. Some states place limits on the amount of IRA income they exclude from tax: limits may depend on the taxpayer's age or the amount distributed or both.

For example, clients living in Mississippi have the same unlimited exclusion as Pennsylvania, but only if they are at least age 59½. Some other states' retirement income exclusions are based on the account owner's birth year (Michigan) or the funding source for the IRA (Hawaii).

Advisors who learn about these varied special rules and how they work can show clients how to trim their state tax liability by planning when — *and where* — to execute Roth conversions.

(We have outlined each state's special income tax provisions in this issue's insert. In addition to the state tax data there, some cities and counties also have income taxes that should be considered when planning for Roth conversions.)

A Matter of Timing

Sometimes our clients move from high-tax areas to states where there are no income taxes.

Example 4: Doug might be looking forward to moving in retirement from New York to Florida to enjoy the sunshine. From a state income tax perspective, we'd suggest that Doug wait for a Roth conversion until after the move, because New York has steep income taxes and Florida has none.

We also have seen the reverse, where an individual might move from an income-tax-friendly state to a state with higher taxes.

Example 5: Erin is thinking of trading in the east coast (Georgia) for the west coast (Oregon), only to find that Oregon's income taxes are higher than Georgia's.

In such a scenario, it might make sense for Erin to convert her traditional IRA to a Roth before moving to high-tax Oregon, paying lower state taxes in Georgia.

Note that Georgia is one of those special-rule states we mentioned earlier, so such a decision would become even more compelling if Erin is age 62 or older before moving and can utilize Georgia's exclusion.

Final Thoughts

High-tax or low(er)-tax, all states like to get their piece of a resident's pie, one way or another. We've revealed how most states get an income tax slice, but there are also state estate and inheritance taxes to consider.

Currently, there are twelve states (plus the District of Columbia) that impose estate taxes and six that impose inheritance taxes. Only Maryland has both.

The general framework for each state's estate tax system is similar: there is an exemption amount and a graduated tax rate on any excess assets, which increases with the value of the taxable estate. State exemptions range from $1 million (Oregon and Massachusetts) to $5.85 million (New York), while the applicable tax rates range from 0.8% (Rhode Island and Maryland) to as high as 20% (Washington and Hawaii).

Clients who live in New York may enjoy your pointing out this fun item (or not!). The New York exemption acts more like a cliff than a gradual slope. If the taxable estate is less than the basic exclusion amount ($5.85 million in 2020), no New York estate tax is due.

But if an estate of a New York resident exceeds that threshold by even $1, the estate tax rate applies, starting with the first dollar of estate value. There is an estate tax credit equal to the taxes incurred on the basic exclusion amount, but that credit is phased out once an estate exceeds $6.1425 million. Not simple, but vital for high-net-worth New Yorkers to know.

Payable on Receipt

State inheritance taxes also tend to follow a general framework. Taxation is based on the decedent's state of residency, rather than the beneficiaries' home states. Nevertheless, it's the beneficiaries — *not the deceased's estate* — who pay the tax.

Each state typically has a graduated tax rate that is based on either the "class" of beneficiary and/or the value of the property being inherited. If the beneficiary receiving the inherited property is in a certain class, or if the value of the property being transferred is under a specific threshold, the tax may be waived. Surviving spouse beneficiaries are exempt from all inheritance taxes and most states (except Nebraska and Pennsylvania) also exempt children.

Why are state estate and inheritance taxes relevant to Roth conversions? Because any federal or state income taxes imposed on the conversion are paid upfront, reducing the size of the overall estate.

Example 6: Frank lives in New York; he has an estate worth $6.2 million, including the value of his large traditional IRA. You might advise Frank to convert IRA money to a Roth and pay the income tax. Such a plan could bring Frank's estate value under New York's $5.85 million exemption amount, for considerable tax savings.

Smart Moves

Example 7: Grace lives in Texas and plans to move to Washington. Neither state has an income tax but Washington, unlike Texas, has an estate tax. You might advise Grace to convert her traditional IRA to a Roth before or shortly after moving to Washington because failing to convert before death could potentially increase her future estate tax liability.

In some cases, Roth conversion strategies should consider state estate or inheritance taxes in conjunction with state income taxes.

Example 7: Henry lives in Florida and wants to move to Maryland to be closer to his family. Here, Henry would go from facing no state income, estate, or inheritance taxes to having to plan for all three!

Because you're aware of the issues described, you could begin mapping out Roth conversions to reduce this state tax triple threat. You might save Henry and his heirs substantial amounts of tax, demonstrating the value of sophisticated advice.

> In some cases, Roth conversion strategies should consider state estate or inheritance taxes in conjunction with state income taxes.

More Pieces to the Puzzle

Some special situations can add an extra layer of complexity when advising clients about Roth conversions. They include:

- Atypical assets in a client's IRA. Assets such as real estate or land require special attention because the rules for real property often depend on the state where the property is located rather than the client's residency.
- Roth conversions during the year of an interstate move. After such conversion, clients could be required to file a part-year resident/non-resident tax return for both their previous and new states. Advisors might suggest converting in the calendar year before or after the year of moving, to simplify tax filing.
- Choosing which pocket to pick for paying Roth conversion taxes. Paying with non-IRA funds promotes more tax-free growth because the IRA won't be depleted.

As financial professionals, we should consider every angle when forming client recommendations. Federal taxes may play the primary role in developing Roth conversion strategies but you can demonstrate the value you're adding by showing the savings that result from your consideration of state income, estate, and inheritance taxes as well.* ■

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**The current state tax rates are based on sources believed to be factual and reliable. The tax rates are subject to change based on changes to tax legislation in each state. The information provided is for informational purposes only and should not be construed as tax or legal opinion. Please consult a tax or financial advisor with questions about your specific situation.*

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How the SECURE Act Affects Annuities in Retirement Plans by **Gayle Canini, MBA, BFA™**

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ED SLOTT'S IRA ADVISOR
is a monthly publication sold for $125 annually by:

Smart Subscriptions, LLC
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Rockville Centre, NY 11570

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ISSN 1531-653X

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Acknowledgments

Thank you to **Sarah Brenner, Andy Ives,** and **Ian Berger** for your consistent attention to detail writing, editing and reviewing each issue. You are truly the best in the business and have earned the national recognition as America's IRA Experts!

Don Korn, thank you for the work you put into working with our Guest Experts.

And to all of **our subscribers**, thank you for your readership and loyalty every month. We wish you and your loved ones a happy, successful, and healthy New Year!

ROTH CONVERSION WITH STATE IRA TAXES

STATE	TOP INCOME TAX RATE	ESTATE TAX	INHERITANCE TAX	UPCOMING CHANGES	SPECIAL TAX EXEMPTIONS
ALABAMA	5.00%	N/A	N/A		Unlimited exclusion for pension income from a defined benefit plan but not for IRA distributions
ALASKA	0.00%	N/A	N/A		
ARIZONA	4.50%	N/A	N/A		
ARKANSAS	6.60%	N/A	N/A		Up to $6,000 in retirement plan benefits, including IRAs if you're age 59½ or older
CALIFORNIA	13.30%	N/A	N/A		
COLORADO	4.63% Flat Income Tax	N/A	N/A		
CONNECTICUT	6.99%	$5.1M Exemption Estate Tax: 10-12%	N/A	Estate Exemption: 2021 - $7.1M 2022 - $9.1M 2023 - Federal Exclusion Amount	
D.C.	8.95%	$5.7624M Exemption Estate Tax: 12-16%	N/A	Estate Exemption: Reduced to $4M in 2021	
DELAWARE	6.60%	N/A	N/A		Up to $12,500 of dividends, capital gains, interest, rental income, and distributions from qualified retirement plans once you're age 60 and older
FLORIDA	0.00%	N/A	N/A		
GEORGIA	5.75%	N/A	N/A	Watch for possible income tax rate changes.	Up to $65,000 of retirement income if you're age 65 or older ($35,000 from ages 62-64); up to $4,000 of the maximum exclusion amount may be earned income
HAWAII	11.00%	$5.49M Exemption Estate Tax: 10-20%	N/A		Unlimited exclusion for DB pensions. Some 401(k) and IRA withdrawals can be exlcuded if funds were rolled over from a plan that would have been excluded
IDAHO	6.93%	N/A	N/A		
ILLINOIS	4.95 Flat Income Tax	$4M Exemption Estate Tax: 0.8-16%	N/A		Unlimited exclusion for DB pensions, 401(k)s, IRAs and certain capital gains/ER stock

Roth Conversion with State IRA Taxes

STATE	TOP INCOME TAX RATE	ESTATE TAX	INHERITANCE TAX	UPCOMING CHANGES	SPECIAL TAX EXEMPTIONS
INDIANA	3.23% Flat Income Tax	N/A	N/A		
IOWA	8.53%	N/A	Inheritance Tax: 0%-15% Does not apply if the estate, as a whole, is worth less than $25,000		Up to $6,000 ($12,000 if married) of pension and other retirement pay if age 55 or older
KANSAS	5.70%	N/A	N/A		
KENTUCKY	5.00% Flat Income Tax	N/A	Inheritance Tax: 0%-16%		Up to $41,110 of income excluded from IRAs and other plans
LOUSIANA	6.00%	N/A	N/A		
MAINE	7.15%	$5.8M Exemption Estate Tax: 0.8-12%	N/A	Estate Exemption: Increased to $5.9M in 2021	
MARYLAND	5.75%	$5M Exemption Estate Tax: 0.8-16%	Inheritance Tax: 0%-10%		
MASSACHUSETTS	5.00% Flat Income Tax	$1M Exemption Estate Tax: 0.8-16%	N/A		
MICHIGAN	4.25% Flat Income Tax	N/A	N/A		Up to $49,861 in retirement income if born before 1946 (new restrictions reduced tax breaks based on year of birth)
MINNESOTA	9.85%	$3M Exemption Estate Tax: 13-16%	N/A		
MISSISSIPPI	5.00%	N/A	N/A		Unlimited exclusion for all retirement plan income, including IRAs, if age 59½ or older
MISSOURI	5.40%	N/A	N/A		
MONTANA	6.90%	N/A	N/A		
NEBRASKA	6.84%	N/A	Inheritance Tax: 1%-18%		
NEVADA	0.00%	N/A	N/A		
NEW HAMPSHIRE	5.00% Only Taxes Interest / Dividend Income	N/A	N/A		
NEW JERSEY	10.75%	N/A	Inheritance Tax: 0%-16% Based on who will receive the decedent's assets and how much each beneficiary is entitled to receive		
NEW MEXICO	4.90%	N/A	N/A		

STATE	TOP INCOME TAX RATE	ESTATE TAX	INHERITANCE TAX	UPCOMING CHANGES	SPECIAL TAX EXEMPTIONS
NEW YORK	8.82%	$5.85M Exemption Estate Tax: 3.06-16% New York estate tax is a "cliff t x." That means if the value of the estate is more than 105% of the current exemption, the exemption won't be available and the entire estate will be subject to state estate tax.	N/A		Up to $20,000 exclusion from IRA income if age 59½ or older
NORTH CAROLINA	5.25% Flat Income Tax	N/A	N/A		
NORTH DAKOTA	2.90%	N/A	N/A		
OHIO	4.80%	N/A	N/A		
OKLAHOMA	5.00%	N/A	N/A		
OREGON	9.90%	$1M Exemption Estate Tax: 10-16%	N/A		
PENNSYLVANIA	3.07% Flat Income Tax	N/A	Inheritance Tax: 0%-15% Tax waived for lineal descendant(s) *IF* age(s) 21 or younger		Unlimited exclusion for all retirement plan income, including IRAs
RHODE ISLAND	5.99%	$1,579,922 Exemption Estate Tax: 0.8-16%	N/A		
SOUTH CAROLINA	7.00%	N/A	N/A		Up to $10,000 of any income if age 65 or older ($3,000 of certain retirement income if under age 65)
SOUTH DAKOTA	0.00%	N/A	N/A		
TENNESSEE	1.00% Only Taxes Interest / Dividend Income	N/A	N/A		
TEXAS	0.00%	N/A	N/A		
UTAH	4.95%	N/A	N/A		
VERMONT	8.75%	$4.25M Exemption Estate Tax: 16%	N/A	Estate Exemption: Increased to $5M in 2021	
VIRGINIA	5.75%	N/A	N/A		
WASHINGTON	0.00%	$2,193,000 Exemption Estate Tax: 10-20%	N/A		
WEST VIRGINIA	6.50%	N/A	N/A		
WISCONSIN	7.65%	N/A	N/A		
WYOMING	0.00%	N/A	N/A		

The current state tax rates are based on sources believed to be factual and reliable. The tax rates are subject to change based on changes to tax legislation in each state. The information provided is for informational purposes only and should not be construed as tax or legal opinion. Please consult a tax or financial advisor with questions about your specific situation.