Updates
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SECURE Act Presents Planning Challenges and Opportunities for Retirement Accounts

The Setting Every Community Up for Retirement Enhancement Act (the SECURE Act) was signed into U.S. law on December 20, 2019. The SECURE Act makes significant changes to the administration of IRAs and other tax-deferred retirement accounts (retirement accounts) during the life of a retirement account owner and after the account owner's death. The following summary highlights the SECURE Act's key changes to tax laws and their potential impact on account owners and their beneficiaries.

Changes Affecting Inherited Retirement Accounts: "Stretch" Payout Provisions Eliminated for Most Beneficiaries

The SECURE Act restricts the use of inherited retirement accounts as tax planning tools, but proper beneficiary designations continue to be critical to a well-thought-out estate plan. Under prior law, qualified designated beneficiaries, including individuals and certain trusts, could take distributions from an inherited retirement account over the beneficiary's remaining life expectancy (or the remaining life expectancy of the oldest beneficiary in the case of a qualifying trust). This "stretch" payout allowed for significant income tax deferral on the retirement account.

In contrast, retirement accounts that either had no beneficiary designation or designated a non-qualifying type of beneficiary (such as a charity, an estate, or a trust that was not properly structured to qualify for the stretch) had to be distributed on a faster timeline or in larger amounts. Generally, these retirement accounts had to be distributed (1) by the end of the fifth calendar year following the account owner's death, if the account owner died before reaching age of 70½, or (2) over the account owner's remaining life expectancy if the owner died after reaching age 70½ (the five-year or life expectancy rule). To avoid the five-year or life expectancy rule, estate planners endeavored to qualify trusts for the maximum stretch payout allowed under prior law.

The SECURE Act replaced the stretch rules with a new default "ten-year rule" for retirement accounts inherited from account owners who died after December 31, 2019. Now, in most cases, the retirement account must be distributed to a beneficiary who would have previously qualified for the stretch by the end of the tenth calendar year following the account owner's death.

The new ten-year rule does not apply to the following eligible beneficiaries:

- The surviving spouse of the deceased account owner
- Minor children of the deceased account owner
- Disabled beneficiaries
- Chronically ill beneficiaries
- Beneficiaries less than ten years younger than the deceased account owner

For these eligible beneficiaries, except minor children, the distribution rules remain largely unchanged under the SECURE Act. Surviving spouses can continue to roll over retirement accounts from their deceased spouses and, with certain exceptions, most other eligible beneficiaries may continue to stretch inherited retirement accounts.

Minor children may continue to stretch the retirement accounts until the child reaches the age of majority; thereafter, the ten-year rule will apply. Certain qualifying trusts for the benefit of an eligible designated beneficiary, **if properly drafted**, will be eligible for extended income tax deferral.

Note: A beneficiary that previously did not qualify for the stretch is still subject to the old five-year or life expectancy rule. Thus, it remains critical to have proper beneficiary designations.

Changes Affecting Account Administration During Account Owner's Life

The SECURE Act also significantly affects the administration of retirement accounts for a living account owner.

Later Beginning Date for Required Minimum Distributions

First, individuals must now begin to withdraw required minimum distribution (RMD) after reaching age 72, rather than 70½. However, this new rule applies only to individuals who did not turn age 70½ prior to January 1, 2020. Otherwise, RMDs must be made under the prior rules, even though the account owner may not reach age 72 until 2021.

Repeal of Maximum Age to Contribute to a Traditional IRA

Second, the age cap for contributing to a traditional IRA no longer exists. Under the SECURE Act, account owners who are older than 70½ and earn income (or whose spouse earns income) may continue contributing to a traditional IRA.

Qualified Charitable Distributions Still Allowed at Age 70½, Subject to New Limitations

Finally, despite the fact that RMDs now begin at age 72, account owners may still make qualified charitable distributions (QCDs) after reaching age 70½ by distributing up to $100,000 directly from their retirement accounts to charitable organizations (other than donor-advised funds or private foundations). A QCD deduction is an "above-the-line" deduction. As an added bonus, QCDs made before the account owner is required to withdraw RMDs will reduce the amount of each RMD.

To prevent account owners from contributing to their traditional IRAs after age 70½ solely for the purpose of making additional QCDs, the SECURE Act also reduces an account owner's deductible QCDs by the cumulative amount of post-70½ deductible contributions made by that account owner. For example, if an account owner older than 70½ makes cumulative contributions of $12,000, and then subsequently makes a QCD of $20,000, only $8,000 of the QCD (the $20,000 QCD minus the $12,000 of post-70½ deductible contributions) will be allowable as an above-the-line deduction. The remaining $12,000 will be an itemized charitable deduction.

Planning for Retirement Accounts after the SECURE Act

The SECURE Act affects all retirement account owners, presenting planning challenges, but also new opportunities.

The laws governing inherited retirement accounts have always implicated the difficult task of balancing tax deferral, tax minimization, control over account assets, and creditor protection. While the SECURE Act does not eliminate these tradeoffs, common planning techniques that were prudent under the old law may no longer be appropriate or desirable.

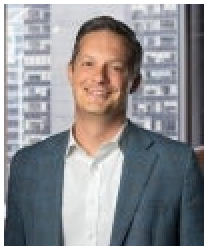
You should review and consider:

- **Your Current Beneficiary Designations:** You may want to designate a new beneficiary if you selected one or more of the following beneficiaries (the list is not exhaustive):
  - A trust that no longer provides the intended benefits (see below)
  - A young beneficiary to take advantage of the longer stretch payout under prior law, but this beneficiary will be too young ten years after your death
  - A family member who has a qualifying disability or chronic illness
  - A beneficiary who is likely to be in the prime of his or her earning years during the expected ten-year period after your death and will pay tax on those retirement benefits at a higher marginal rate than would another potential beneficiary
- **The Distribution Provisions of Any Receiving Trusts:** Leaving retirement account assets to a trust has always required special attention and expertise. Trusts that qualified for stretching under prior law will now be subject to the ten-year rule and may no longer accomplish your goals. For example, under prior law, practitioners commonly used a trust that required the immediate distribution of RMDs to the trust beneficiary (a so-called "conduit trust") because the trust could easily be structured to qualify for the stretch. However, this trust may now lead to an unintended result if, for example, the beneficiary is young and will receive all assets within ten years. Another popular qualifying trust (a so-called "accumulation trust") enables the trustee to retain RMDs and distribute them based on various standards or in the trustee's discretion. Switching to an accumulation trust may better achieve your planning objectives.
- **Roth Conversions:** Because distributions from a Roth retirement account are not taxable to the beneficiary, you may wish to convert your traditional accounts into Roth accounts if you anticipate your accounts will grow significantly after your death or your beneficiaries will have a much higher marginal tax bracket than you do currently.
- **Buying Life Insurance to Alleviate Acceleration of Income Taxes:** With fewer opportunities to defer income tax, you may focus on providing sufficient liquidity to your beneficiaries to pay any accelerated income taxes. Beneficiaries can pay taxes on an inherited retirement account in a tax-efficient manner by using life insurance proceeds (particularly if payable to an irrevocable life insurance trust).
- **Setting Up and Designating a Charitable Remainder Trust:** If you are charitably inclined, you may want to designate a charitable remainder trust (CRT) to receive your retirement account assets. This trust would receive all the assets without tax within ten years after your death, pay a fixed percentage of the trust's assets to your non-charitable beneficiary for life (with such beneficiary paying some income tax on those distributions), and at the death of your non-charitable beneficiary, distribute the remainder interest to your designated charity. CRTs accumulate income and are not taxed on that income, replicating, to some extent, the tax deferral from stretching and income stream management available to qualifying trusts under prior law.
- **Administering Your Accounts Differently:** If you are nearing age 70½, or are already past that age, consider continuing contributions and delaying distributions from your retirement accounts, or making QCDs, particularly if you are still working and do not depend on your retirement account to support your lifestyle.

In light of the SECURE Act, we are prepared to assist in reviewing your existing estate plans and coordinating your beneficiary designations with your overall tax and estate planning objectives.

You should consult with your estate planning attorney, income tax advisor, or other planning professional to address your individual circumstances.

Authors



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