SECURE Act Impact on Estate Planning

Alert
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The Setting Every Community Up for Retirement Enhancement (SECURE) Act was made a part of the appropriations bill late in 2019 and was signed into law on December 20, 2019. **In light of this new law, you should review beneficiary arrangements on all IRAs and tax-qualified retirement plans—the same planning that was appropriate before 2020 may yield much worse results under the new law.**

There are a few changes made under the SECURE Act that will yield positive results for those affected. A change in the law moves back the "required beginning date" (the date by which mandatory distributions must begin to an IRA owner/plan participant) from April 1 of the year following the year in which the IRA owner/plan participant reaches age 70ffl, to April 1 of the year following the year in which the IRA owner/plan participant reaches age 72. That could be a benefit to people who were not yet age 70ffl on December 31, 2019 and who are not in need of income from their IRAs/retirement plans. The act also eliminates the maximum age limit for contributing to a traditional IRA.

However, the SECURE Act contains a number of provisions that may yield negative tax and estate planning results for those affected. For example, the SECURE Act shortens (to 10 years) the period over which certain beneficiaries must withdraw an IRA/retirement plan balance after the death of the owner of the account. Prior law allowed many beneficiaries of IRAs/tax-qualified retirement plans, and properly structured trusts set up for those beneficiaries, to withdraw the account balances in installments spread over the designated beneficiaries' lifetimes. Because income from this type of account is not recognized until actually received by the beneficiary, the option to spread withdrawals over the beneficiary's lifetime under the old law often allowed deferral of a significant portion of the income tax associated with the account. The ability to withdraw relatively smaller amounts from the account in the early years of a beneficiary's lifetime resulted in the bulk of the IRA/plan benefit remaining in the account for a significant period, growing on an income-tax-free basis.

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The changes required under the SECURE Act mean that for deaths occurring on or after January 1, 2020, many beneficiaries will no longer be able to use their life expectancy to determine their required minimum distribution from an inherited account. Instead, the beneficiary will be required to withdraw inherited IRA/tax-qualified retirement plan assets within 10 years of the account owner's death (in installments or in a lump sum at any time during that period).

Moreover, some beneficial planning that was done before 2020 may now, if left unchanged, actually yield worse results for your beneficiaries at the time of your death. As just one example of this, under the old law sound tax and estate planning sometimes utilized trusts as the beneficiary of IRA/retirement plan proceeds, and those trusts were structured so that (by using the trust beneficiary's life expectancy) relatively small amounts needed to be withdrawn from the IRA/retirement account on an annual basis. That kept current income taxes low and allowed the trustees to keep the bulk of the IRA or retirement plan assets in the IRA or retirement account and thus under the control of the trustee. Those types of trusts are often used so that the trustee manages the assets rather than turning control over to young or vulnerable beneficiaries, or to beneficiaries that are simply not yet equipped to handle financial assets. Under the new law some of those trust arrangements, if left in place, may now result in:

- The need to withdraw much larger distributions from the IRA or retirement plan account over a shorter period of time, thus accelerating income tax
- A requirement that the trustee distribute all the inherited retirement account funds, in the year they are withdrawn from the account, directly to beneficiaries who might have otherwise greatly benefited from management by the trustee

The 10-year payout rule will generally apply to many typical beneficiaries, such as most adult children, grandchildren of any age, nieces and nephews.

The 10-year rule does not apply to:

- Spouses (who generally have all of the same options that were available to them before the SECURE Act)
- A beneficiary that is not more than 10 years younger than the IRA owner/plan participant (an example of this might be a life partner, or one or more siblings)
- Minor children of the account owner (but only until they reach the age of majority or, in some instances involving ongoing education, age 26)
- Disabled and chronically ill beneficiaries

Those four categories of beneficiaries (and properly structured trusts for them) can still spread withdrawals out over their lifetimes. However, these exceptions also have limitations. For example, the exception for a minor child evaporates when the child reaches the age of majority, and from that point on the child will be required to take out all of the account assets within 10 years.

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Under the right circumstances there may be planning options available to lessen the financial impact of the SECURE Act. Such options may include:

- **Charity:** Using IRA/tax-qualified retirement plan assets for direct charitable gifts (at death, or during lifetime in some instances), or using them to fund charitable remainder trusts upon death.
- **Roth Conversions:** The SECURE Act will cause many to consider converting a regular IRA to a Roth IRA during lifetime. Doing so will cause some income tax now, but under some circumstances it will cost less tax over the long haul. Also, the owner of a Roth IRA is not required to take distributions during his or her lifetime, thus allowing the Roth IRA to grow income tax free. The Roth IRA is not subject to income tax when paid to beneficiaries after the owner's death, although the beneficiaries will need to withdraw the Roth IRA funds within 10 years of the owner's death.
- **Life Insurance:** In some circumstances withdrawing money from an IRA or retirement plan during lifetime, paying the income tax, and then using the remaining amount to purchase life insurance can yield an income-tax-free and estate-tax-free inheritance upon death.
- **"Accumulation Trusts":** Trust provisions can be altered so that, even if the 10-year payout rules apply, the assets distributed to a trust from an IRA or retirement plan can remain in the trust to be managed by the trustee for the benefit of young, vulnerable or financially inexperienced beneficiaries, or to complement or enhance the beneficiary's own tax and financial planning goals.

Each IRA or retirement plan account holder may be impacted differently. The results described above may not be materially detrimental for all beneficiaries, but for others the results under the new law will be much less favorable than under previous law. The best way to determine whether you should make changes to your plan, or whether some or all of the planning options noted above are right for you, is to review your plan with professional assistance. We advise you to do so as soon as possible.

The provisions of the SECURE Act discussed above are effective for deaths that occur after December 31, 2019, so the possible negative implications of this law pose a financial risk to your beneficiaries now. Please contact our Tax, Trusts & Estates team soon to consider your best options.

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