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The SECURE Act Upends Planning for Retirement Accounts

Clients should review their estate planning strategy and contact their Blank Rome attorney as soon as possible to determine if any revisions are necessary or advisable to account for the recently enacted SECURE Act, particularly if any beneficiary (primary or contingent) of their qualified retirement accounts is a trust.

The Setting Every Community Up for Retirement Enhancement Act (the "SECURE Act") was enacted on December 20, 2019, as part of a major appropriations bill. The SECURE Act is intended to make it easier for a broad range of individuals to save for retirement and includes several taxpayer friendly provisions.

However, as a revenue raising measure, the SECURE Act also significantly curtails a common estate planning strategy referred to as a "stretch IRA." The "stretch" was obtained when a non-spouse designated beneficiary (for example, a child or grandchild) or certain kinds of trusts inherited a qualified retirement account (including an IRA or 401(k)) and was able to withdraw the funds in annual installments based on the life expectancy of the beneficiary. The life expectancy tables assume a life expectancy of approximately age 83, which allowed for potentially decades of tax deferral in the case of a young beneficiary.

Taxpayer Friendly Provisions

Some of the benefits of the SECURE Act include the following:

- Increases the age at which owners of retirement accounts must begin taking annual required minimum distributions ("RMDs") from April 1st of the year after the year in which the account holder attains age 70½ to April 1st of the year after the year in which the account holder attains age 72. Individuals who did not reach age 70½ by December 31, 2019, can take advantage of the new rule.

- Allows contributions, regardless of a person's age, to a traditional IRA as long as the person is still working. Under prior law, a person could not make such contributions after the year in which the taxpayer attained age 70½. However, such contribution will reduce the amount of the qualified charitable distribution that a participant may make in such year from his or her retirement account directly to an eligible charity that may count toward his or her RMD.

- Allows penalty free withdrawals (the 10 percent early withdrawal penalty is waived) from retirement accounts of up to $5,000 within one year of the birth or adoption of a child.

- Authorizes tax-free distributions of up to $10,000 from a 529 plan to pay the principal and/or interest on a qualified education loan for the designated beneficiary (or his or her sibling) of the 529 plan.

- Note that the new rules continue to permit Roth IRA and Roth 401(k) holders to maintain their accounts without having to take any required minimum distributions.

Stretch IRA Planning is Substantially Eliminated

There will now be two sets of rules for inherited retirement accounts. The demarcation line is whether the account was inherited before January 1, 2020. Accounts inherited prior to that date will continue to be governed by pre-SECURE Act law, except that if the initial beneficiary dies before the retirement account is completely withdrawn, the successor beneficiary is now subject to the 10-year rule (described below).

Pre-SECURE Act Law

Generally, the following options were available for retirement accounts prior to the enactment of the SECURE Act:

1. **Spouse.** If a surviving spouse was the designated beneficiary, the spouse typically elected to roll-over the account into another plan in which the spouse is the participant, which would require taking RMDs starting the earlier of (x) the year of death or (y) the year in which the surviving spouse attains age 70-½, over his or her life expectancy. The surviving spouse could then designate his or her own beneficiaries of the plan.

2. **Individual Other Than a Spouse.** If an individual other than a surviving spouse (such as the account holder's child) was the designated beneficiary, the beneficiary could choose to withdraw the funds in the account based on his or her life expectancy (or, if younger, the participant's life expectancy), beginning December 31st of the year following the year of death (note that if the participant died after his required beginning date (typically age 70½) the final RMD for the deceased participant must be taken in the year of death as well).

3. **Trust as Beneficiary.** The rules for trusts as beneficiaries of retirement plans were (and still are) very complex. Generally speaking, a trust does not qualify as a "designated beneficiary" and therefore must withdraw benefits payable to it by the end of the fifth year following the year in which the account holder dies. The exception to this rule was for trusts qualifying as "See-Through Trusts," which permitted withdrawals over the life expectancy of the individual beneficiary of the trust. The most common way for a trust to qualify as a See-Through Trust is to require that all distributions from a retirement plan payable to a trust be distributed directly to the trust's beneficiary.

Post-SECURE Act Law

In the case of a retirement account inherited after January 1, 2020, the entire account balance must be distributed by the end of the tenth year following the year in which the account holder dies, if the beneficiary is an individual (or See-Through Trust for the benefit of an individual) who is not an Eligible Designated Beneficiary ("EDB"). There are no annual required distributions during this 10-year period. If the beneficiary is not an individual, or is a trust that does not qualify as a See-Through Trust (a "Non-Designated Beneficiary"), then the entire account balance must be distributed by the end of the fifth year following the year in which the account holder dies.

The following individuals are EDB's and may continue to use their life expectancy to compute payouts:

(i) a surviving spouse (a surviving spouse generally still continues to have the same options under pre-SECURE Act law as described above);

(ii) a minor child, provided that life expectancy payments must be converted to a 10-year payout period beginning when the child attains the age of majority (age 18 in most states);

(iii) a disabled or chronically ill individual, within the meaning of the Internal Revenue Code, and

(iv) an individual not more than 10 years younger than the account holder (for example, a sibling of the account holder).

Impact on Current Estate Plans

Every estate plan in which the beneficiary (primary or contingent) of a retirement account is a trust must be reviewed as soon as possible. Even if your plan does not involve a trust as a potential beneficiary, a review of your plan may be warranted to determine if any other revisions are necessary or advisable to optimize your plan to account for these changes.

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In most cases the "retirement plan" clause in your Will or Living Revocable Trust will have to be amended in order to ensure the longest possible distribution period. In particular, you will likely want to take steps to avoid having to distribute all of your retirement plan assets either (a) outright to a trust beneficiary within 10 years of your death or (b) outright to a "Non-Designated Beneficiary" within five years of your death.

1. **Review Beneficiary Designations.** All beneficiary designations should be reviewed to confirm that the impact of the SECURE Act still meets with the client's goals and objectives. For example, if an adult child is an outright beneficiary of a retirement plan, the child must take a lump-sum distribution after 10 years. This could have negative asset protection and income tax implications that may be mitigated through changes or enhancements to the balance of the estate plan.

2. **Review Wills and Trusts.** If a beneficiary designation names a trust as the designated beneficiary, the terms of the trust must be reviewed to determine the impact of the SECURE Act on the original intent of the estate plan. For example, many estate plans designate a trust as either the primary or contingent beneficiary and those trusts were designated so that the RMDs were distributed to the beneficiary (often a child or grandchild) over the beneficiary's life expectancy and was obligated to distribute such RMDs to the beneficiary. This may have made sense when the RMDs were expected to be relatively modest due to the utilization of a multi-decade stretch. A conduit trust under post-SECURE Act law would require not only all of the retirement plan assets be withdrawn from the retirement account by the end of the tenth year following the year in which the account holder dies, but also that those amounts be distributed outright to the beneficiary.

Clients in this (or similar) situations may want to consider amending their plans to accumulate the RMDs in a trust rather than distributing the RMDs outright from the trust to the beneficiary after 10 years. This would likely require an update to existing Wills and Trusts that are, or may be, designated as beneficiaries of retirement plan assets.

Clients who would like more information about their specific circumstances should contact a member of Blank Rome's Private Client group.

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