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Trusts & estates

Retirement benefits planning under the SECURE Act

PROFESSIONAL OPINION

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The Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE") was passed by Congress in December of last year. The provisions of SECURE became effective on January 1, 2020. Although SECURE applies to various types of qualified retirement plans—which allow for income tax-deferred savings of compensation and investment income—this article refers exclusively to IRAs.

Impact of SECURE on inherited IRAs

With the exception of five types of IRA beneficiaries ("eligible designated beneficiaries"), individual beneficiaries inheriting an IRA from an IRA owner dying after December 31, 2019 now lose the ability to stretch required minimum distributions ("RMDs") over their life expectancies. Under SECURE, the inherited IRA must be fully distributed to the beneficiary during the 10-year period following the IRA owner's death.

An IRA inherited by an individual beneficiary from a decedent who died on or before December 31, 2019 is "grandfathered" under the old stretch rules and, therefore, not subject to the new 10-year payout rule. Thus, the beneficiary of such an IRA continues to be eligible to take RMDs.

The new 10-year payout rule does have some flexibility: No annual distributions are required, but the inherited IRA must be fully distributed by the end of the year which includes the 10th anniversary of the IRA owner's death.

The five types of "eligible designated beneficiaries" who are, under SECURE, still entitled to take advantage of the life expectancy payout (or stretch) rule—or at least some modified version thereof—are as follows:

1. Surviving spouse of the IRA owner.
2. Minor child of the IRA owner. (But only until the child reaches the age of majority, at which point the 10-year payout is triggered.)
3. Disabled beneficiary.
4. Chronically ill beneficiary.
5. Beneficiary who is less than 10 years younger than the IRA owner.

Effect of SECURE on existing estate plans

Any existing estate plan, including a client's will or revocable living trust and coinciding IRA beneficiary designations, which is intended to provide for a stretch payout of an IRA over the life expectancy of the IRA beneficiary must now be reviewed, reconsidered and possibly updated.

Plans including "conduit" trusts: A conduit trust provides that all distributions from an IRA payable to the trust (named as the designated beneficiary of the IRA) must be distributed in full to the lifetime trust beneficiary. Pre-SECURE, the lifetime beneficiary of a conduit trust was eligible for the life expectancy payout. Under SECURE, unless the trust beneficiary is an eligible designated beneficiary, the entire IRA must be withdrawn by the trust and distributed to the trust beneficiary within 10 years after the IRA owner's death. This result will be dramatically different than what was originally intended since, by naming a conduit trust as the IRA beneficiary, the IRA owner anticipated that the IRA would be paid out over the life expectancy of the trust beneficiary.

Plans including see-through "accumulation" trusts: An accumulation trust provides that the trustee may accumulate IRA distributions to the trust (named as the designated beneficiary of the IRA) during the lifetime of the trust beneficiary. Pre-SECURE, an accumulation trust was eligible for the life expectancy payout—based on the life expectancy of the oldest trust beneficiary—provided that all the trust beneficiaries (i.e., the lifetime beneficiary and all remainder persons) were identifiable individuals. Under SECURE, it appears that even if the lifetime beneficiary is an eligible designated beneficiary, the 10-year payout applies because the lifetime beneficiary is not deemed to be the sole beneficiary of the trust (since accumulated IRA distributions to the trust will ultimately pass to the trust remainder persons). Hence, the life expectancy payout is no longer an option for accumulation trusts in any case. Exception: An accumulation trust for a disabled or chronically ill beneficiary still qualifies for stretch payout over the life expectancy of the trust beneficiary.

Planning ideas

In order to reduce the income tax burden of a 10-year payout under SECURE, consider the following ideas:

Eligible designated beneficiaries: Are there people your clients may want to benefit from their estate plans who still qualify for the life expectancy payout under SECURE? If so, consider revising plans to substitute such people as beneficiaries for current beneficiaries who would otherwise be subject to the 10-year payout. For example, if your client has a disabled grandchild, consider naming a lifetime special needs trust for the disabled grandchild as an IRA beneficiary.

Conduit vs. accumulation trusts: Consider updating plans to include conduit trusts with eligible designated beneficiaries, instead of accumulation trusts, as designated IRA beneficiaries.

Charitable remainder trusts: Consider designating a charitable remainder trust as the beneficiary of your IRA. This plan will essentially eliminate the income tax on the IRA per se while providing a lifetime payout to your individual beneficiaries that replaces the lost life expectancy payout under SECURE.

Roth IRA conversions: If an IRA owner is in a lower tax bracket than his intended beneficiaries (for example, an accumulation trust which will pay tax at the highest bracket—37%—on accumulated IRA distributions), consider a Roth conversion during the IRA owner's lifetime. The income tax burden of the Roth conversion can be absorbed by the IRA owner at a lower tax rate than will apply to his or her future beneficiaries. (Note that Roth IRAs are also subject to the 10-year payout under SECURE, albeit with no income taxes due on the Roth IRA distributions over the 10-year payout period.)

Finally, it is important to realize that the 10-year payout rule may not be avoided in all cases. Don't let the tax tail wag the dog! In many cases, rather than worrying about the increased tax burden, clients will simply want to focus on who their intended beneficiaries are and the way in which they want their beneficiaries to inherit their benefits.

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