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Trusts & Estates Alert: How the SECURE Act Impacts Your Estate Plan

By Deborah Pechet Quinan on February 24, 2020

The Setting Every Community Up For Retirement Enhancement ("SECURE") Act was signed into law on December 20, 2019, with an effective date of January 1, 2020. The Act makes sea changes to the planning landscape for qualified retirement plans, requiring that IRA, 401(k), and other qualified retirement plan beneficiaries of individuals who die on or after January 1, 2020, must withdraw their inherited accounts over 10 years, instead of over the beneficiary's life expectancy. This law significantly accelerates the government's receipt of the income taxes due on each distribution, which is not the planning result that most people anticipated when they named their primary and contingent beneficiaries.

There are limited exceptions to this rule for a surviving spouse, a minor child, a disabled or chronically ill individual, and an individual who is less than 10 years younger than the deceased account owner ("eligible designated beneficiaries" or "EDBs"). EDBs can receive distributions over their life expectancies, but at death or attaining the age of majority (which may be as young as age 18, or as old as age 26 if the child is "in a specified course of study"), the 10-year payout rule applies. Since non-minor children are not EDBs, they will receive their distributions within 10 years of attaining majority age. This could be disastrous, depending on the child's personal circumstances. Many beneficiaries will be pushed into higher income tax brackets as a result of this compression, and the inherited accounts will only grow on a tax-deferred basis for 10 years.

REVIEWING YOUR PLAN

Many individuals have named their trusts as the beneficiaries of their qualified plans for various reasons, including consuming their estate tax exemptions, protecting the assets from a child's creditors, safeguarding against divorce, substance abuse, or mental health concerns, and preventing the assets from being distributed to the children before they are financially responsible. Due to the new law, reviewing the trust terms and beneficiary designations in the context of current family circumstances is imperative. In many instances, the trust's retirement plan provisions will need to be updated. In others, only the beneficiary designations will need to be changed. Due to the complexities of the law and the unique circumstances of each family, there is no one-size-fits-all solution to the issues presented by the new law.

Although there are some favorable lifetime distribution changes, such as increasing the age for required minimum distributions from 70.5 to 72 for individuals under age 70.5 on December 31, 2019, and elimination of the age cap for IRA contributions for those with earned income, the most consequential aspect of the Act is its elimination of the so-called "stretch" IRA. As noted above, the 10-year distribution requirement may result in unintended consequences, particularly for most non-spouse "conduit" trust beneficiaries (see below), who will now receive their inherited retirement plans over 10 years rather than over their lifetimes.

Little has changed for those designating a surviving spouse as the beneficiary of retirement assets. Surviving spouses are EDBs and as such are eligible for a life expectancy payout. Spousal IRA rollovers are still available. In most instances, naming the surviving spouse as the beneficiary of a "conduit" trust still works to maximize income tax deferral, use estate tax exemptions, and provide creditor protection benefits.

CAREFUL PLANNING IS THE KEY

The 10-year payout rule creates a significant dilemma for participants who wish to name their young, non-disabled, or non-chronically ill children as primary or contingent beneficiaries via their trusts. Under pre-SECURE Act law, a well-crafted estate plan for those with significant retirement assets often included so-called "conduit" trust provisions. A conduit trust requires all retirement plan distributions made to the trust during the trust beneficiary's lifetime, to be distributed out to the beneficiary. Where minimum required distributions used to be calculated based on the beneficiary's life expectancy and stretched out over his or her lifetime, this was often the recommended approach, particularly for those with young children. Conduit provisions will now result in the entirety of the retirement account being distributed out to the beneficiary within 10 years after attaining majority age. This new, compressed payout period will frequently conflict with the plan participant's intentions at the time the estate plan was established.

An alternative to the conduit trust is the accumulation trust, which allows the trustee to accumulate its retirement account distributions rather than forcing them out to the beneficiary. With the exception of an accumulation trust of which the sole beneficiary is a disabled or chronically ill person, an accumulation trust will <u>not</u> qualify for the life expectancy payout under the new law, even for an EDB[1] This will result in the retirement benefits being distributed out to the trust within 10 years after the account owner's death and taxed at the highest trust income tax rates, irrespective of the beneficiary's qualification as an EDB. Since trusts are currently taxed at the 37% rate for trust taxable income in excess of $12,950, this strategy will be very costly. However, if designated to an accumulation trust, the trustee will be able to exercise her, his or its judgment in deciding when and how much of the retirement assets to distribute to the children. The trustee will need to weigh the high income tax cost to the trust against the financial and personal maturity of the children, and can make year-end distributions to them to mitigate these tax consequences. Careful planning with the advisory team is critical under these circumstances.

Although the SECURE Act has drastic implications for estate planning, there are strategies available for managing the income tax consequences of accelerated retirement account distributions. These include, but are not limited to, Roth IRA conversions, life insurance, charitable planning, and spousal disclaimers, all aimed at combating the anticipated income tax bill.

Roth IRA conversions may be a good choice for those in a low-income tax bracket relative to that of their intended beneficiaries, such as retirees who are under age 72. Converting a traditional IRA to a Roth IRA requires the participant to pre-pay the income tax on the IRA in the year of conversion, and can be done in tranches over time. Post-death Roth IRA distributions are subject to the new 10-year payout rule, but there are no minimum required distributions during the participant's lifetime. As a result, the Roth IRA assets grow on a fully tax-deferred basis for the participant's lifetime.

Those who are charitably inclined may wish to designate some portion or all of their retirement assets outright to a charity or to a charitable remainder trust ("CRT"). A CRT provides cash flow to the beneficiary for his or her lifetime or for a period not to exceed 20 years; the distributions are taxed to the beneficiary. At the end of the term, the remaining trust assets pass to charity free of income tax. This strategy extends the income stream to a non-EDB beneficiary beyond the 10 year period that would otherwise apply, and can be incorporated into an estate plan in conjunction with life insurance purchased to replace the assets ultimately passing to charity. Although the entire value of the qualified retirement plan account will be included in the account owner's estate, the estate will receive a charitable estate tax deduction for the future value projected to pass to charity. One approach would be to name the surviving spouse as the primary beneficiary, and for the CRT benefitting the children to be named as the contingent beneficiary. The CRT could also be drafted to benefit the surviving spouse for life and pay the balance in the trust to charity upon the spouse's death, thus qualifying the account for both the marital and charitable estate tax deductions.

For those who prefer not to mandate a charitable donation in their estate plan, an alternative strategy allows the surviving spouse to choose to disclaim some portion of the retirement assets to charity. In this instance, a charity would be named as the contingent beneficiary of the retirement account. Still another strategy would be to purchase life insurance on the participant's life to a) fund the income tax burden caused by the compressed 10-year distributions or b) replace the amount projected to pass to charity as described above. This life insurance would be purchased by an irrevocable life insurance trust in order to keep the death benefit out of the participant's taxable estate.

Due to the inherent complexities of the issues caused by the interplay between income tax, estate tax, investment returns and family circumstances, it is essential that those with significant retirement plan assets carefully review all of their beneficiary designations and consult with their specialized tax and estate planning advisors to determine whether a change to either their trusts or to their beneficiary designations is advisable.

To find out more about how the information contained in this Client Alert may impact your personal estate plan, please call your attorney at Ruberto, Israel & Weiner and she or he will arrange for a meeting with one of the attorneys in our Trusts & Estates Group.

This article was co-authored by Deborah Pechet Quinan and Deborah Qualia Howe. Deborah Pechet Quinan is the Chair of RIW's Trusts & Estates Practice Group. Deborah can be reached at dpq@riw.com or 617-742-4200.

[1] See LISI Employee Benefits and Retirement Planning Newsletter #713 (December 26, 2019) at http://www.leimbergservices.com, Copyright 2019 Leimberg Information Services, Inc.

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