WINTER 2020 NEWSLETTER

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The Setting Every Community Up for Retirement Enhancement Act of 2019, called the “SECURE Act” makes significant changes to how IRAs and certain retirement benefits must be treated post-death.

These changes are so significant every such IRA plan holders should review their wishes and how their estate plans may be affected. The good news is that the SECURE Act will: (1) give more part-time workers the opportunity to participate in a 401(k) plan; (2) give people the chance to contribute to traditional IRAs for as long as they desire (current rules prohibit contributions to a traditional IRA by taxpayers who are age 70 ½ and older); (3) shift the required minimum distribution age for retirement accounts from 70 ½ to 72 years of age (giving workers an additional 18 months to take advantage of the tax benefits of their retirement accounts before being required to begin taking annual withdrawals); and (4) allow for penalty-free withdrawals under special circumstances (for example, the SECURE Act will allow penalty-free withdrawals from a retirement account of up to $5,000 by parents following the birth or adoption of a child).

The bad news is that the SECURE Act will eliminate the current ability of non-spouse beneficiaries to stretch out distributions from an inherited IRA over the life expectancy of the beneficiary. Under current law, a non-spouse individual beneficiary of a decedent’s retirement account who establishes an inherited IRA with his or her share of the retirement account, may take annual minimum required distributions from the inherited IRA over his or her lifetime. For example, if you inherit your father’s IRA at the age of 50, you are allowed, under current law, to take required minimum distributions (which are taxable income) annually from your inherited IRA over your life expectancy (34 years according to the IRS tables used to measure actuarial life expectancies—so until age 84).

Under the SECURE Act, however, **an inherited IRA must be distributed in full during the 10-year period following the retirement account owner’s death**. The 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 10th year. So, for example, an inherited IRA can be withdrawn in 1/10 increments over 10 years or, instead, the entire account can be withdrawn at the end of the 10th year. Careful income tax planning will dictate how an inherited IRA should be distributed to the beneficiary over the course of the 10-year payout period. In any case, the 10-year payout rule will likely subject the inherited IRA to more income taxes over a much shorter period of time than under current law. For example, in the case cited above, the 50-year old son of the retirement account owner would be required to receive a full distribution of his inherited IRA between the age of 50 and 60 years old, rather than being allowed to withdraw the account over a period of 34 years until reaching the age of 84.

There are certain exceptions to the new 10-year payout rule under the SECURE Act: (1) As under current law, a surviving spouse will still be allowed to roll over a retirement account inherited from a deceased

spouse into his or her own IRA and, going forward, take annual required minimum distributions from the inherited IRA assets over the surviving spouse's lifetime; (2) disabled or chronically ill beneficiaries will have the same option; and (3) minor beneficiaries will be allowed to use their life expectancies to measure annual required minimum distributions until they reach the age of majority (18 in New York), at which point the beneficiary will be subject to the 10-year payout rule.

IRA Trust Planning

If the SECURE Act becomes law, IRA trust planning will have to be reviewed and possibly reconsidered. It is currently standard practice for people to designate a trust as the beneficiary of their retirement account. This allows the retirement account owner to control the future distribution of his or her retirement account after death. Oftentimes, retirement account owners will use a trust to prevent the beneficiary of the retirement account from squandering his or her inheritance. Another reason to name a trust as the beneficiary of your retirement account is to provide the trust beneficiary with asset protection against creditors' claims or claims of a spouse in connection with a divorce.

The two IRA trusts used for this purpose are commonly known as "conduit" trusts and "accumulation" trusts. Under current rules, if the IRA trust qualifies as a "see-through" trust, the trust beneficiaries are treated as if they were named as the direct beneficiaries of the retirement account and the stretch payout is permitted (over the life expectancy of the oldest trust beneficiary).

With a conduit trust, required minimum distributions are paid from the inherited IRA to the trust and then paid from the trust to the trust beneficiaries. The beneficiaries pay income taxes on the distributions at their own personal tax rates. With an accumulation trust, the trustee has discretion to pay out the required minimum distributions paid to the trust to the trust beneficiaries or, instead, accumulate the distributions inside the trust (thereby preserving the distributions and growing the value of the trust).

As a result of the SECURE Act becoming law, and the 10-year payout rule, IRA trust planning will become less effective for income tax planning. With a conduit trust, the inherited IRA will have to be paid out and taxed to the trust beneficiaries over the 10-year period following the IRA owner's death. With an accumulation trust, if the trustee chooses to accumulate annual required minimum distributions inside the trust over the 10-year payout period, those distributions will be subjected to income taxes payable by the trust itself. Trusts pay income taxes at the same rates as do individual taxpayers, but the tax brackets for a trust are **severely compressed** compared to the same brackets applied to individuals. For example, a trust begins paying income taxes at the highest rate of tax (37%) once the trust's taxable income exceeds $12,750, whereas a married couple filing jointly is not subject to this same rate until earning taxable income of over $612,350.

Regardless of whether the SECURE Act becomes law, the non-tax reasons for naming a trust as the beneficiary of your retirement account—protecting your beneficiary's inheritance from being squandered or attached by his or her creditors or spouse in connection with a divorce—will remain important. For these reasons, and despite the tax consequences, people will continue to use trusts to hold their retirement accounts after death. But if the SECURE Act becomes the law of the land, the tax consequences of IRA trust planning will have to be scrutinized on a case-by-case basis in order to determine how best to structure your IRA trust