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ATTORNEYS AT LAW

CLIENT ALERT

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2020 Wills, Trusts & Estates Winter Alert

Signed into law on December 20, 2019 and effective January 1, 2020, the SECURE Act (Setting Every Community Up for Retirement Enhancement Act of 2019) makes significant changes to long-standing rules governing qualified retirement plans, including 401(k) and 403(b) plans, and IRAs (sometimes referred to as "retirement assets"). The changes affect both lifetime planning and the manner in which retirement assets may be distributed to beneficiaries at death. Following are some of the key elements of the SECURE Act:

Repeal of maximum age for traditional IRA contributions

The SECURE Act has repealed Section 219(d)(1) of the Internal Revenue Code, which did not permit contributions to traditional (non-Roth) IRAs after age 70 ½. As of January 1, 2020, contributions may be made to a traditional IRA at any age, so long as the individual has earned income at least equal to the contribution.

Increase in Required Minimum Distribution age from 70 ½ to 72

Prior law required traditional IRA owners and retired qualified retirement plan participants to begin taking required minimum distributions (RMDs) by April 1 of the calendar year following the year in which they attained age 70 ½. As of January 1, 2020, the SECURE Act increases the RMD age from 70 ½ to 72 for individuals who were not yet required to take distributions under the old law. The SECURE Act thus gives individuals born after June 1949 the ability to allow their traditional IRA or qualified retirement plan assets to continue to grow on a tax deferred basis for an additional 1 ½ years.

Elimination of stretch payout

The SECURE Act change with the most significant estate planning impact is the elimination, with very limited exceptions, of "stretch IRA" distributions to designated beneficiaries following the death of the plan participant or IRA owner. Prior law permitted designated beneficiaries (individuals and certain trusts, typically known as "see-through" trusts) to stretch out distributions over the life expectancy of the beneficiary, allowing for income tax minimization and tax-deferred growth of retirement assets and protection of the retirement assets from the beneficiary's creditors.

Under the new law, for deaths of plan participants or IRA owners beginning in 2020 (later for some participants in collectively bargained plans and governmental plans), distributions to individual beneficiaries other than a surviving spouse are generally required to be distributed by the end of the tenth calendar year following the death of the plan participant or IRA owner.

Many existing estate plans crafted under the old law designate a particular type of see-through trust, known as a conduit trust, usually for the benefit of children and grandchildren, as the beneficiary of retirement assets. Conduit trust planning requires annual RMDs to be distributed from the retirement plan or IRA to the conduit trust and then distributed out to the beneficiary, calculated prior to the SECURE Act using the life expectancy of the trust beneficiary. With certain limited exceptions, the SECURE Act largely eliminates the advantages of conduit trust planning. The life expectancy payout period has been replaced with a 10 year payout period. Distributions may be made in interim distributions of any amount over the 10 year period or in a lump sum at any time during the 10 year period, but must in all events be completed no later than 10 years after the death of the plan participant or IRA owner.

Exceptions to the 10-year rule are permitted for distributions to "eligible designated beneficiaries," defined as:

(1) The surviving spouse of the plan participant or IRA owner.

(2) A child of the plan participant or IRA owner who has not reached majority. When the child reaches majority, the 10-year rule will apply so the plan assets will have to be paid out by the tenth year after the child reaches majority.

(3) A disabled or chronically ill individual.

(4) Any other individual who is not more than 10 years younger than the plan participant or IRA owner.

Eligible designated beneficiaries falling within the categories described above may take distributions over their life expectancy (with the exception for minor children who reach majority as noted above).

Spousal Rollovers

The rules allowing a surviving spouse to rollover retirement assets to his or her own IRA are unaffected by the SECURE Act.

Beneficiaries that are not "Designated Beneficiaries"

The SECURE Act leaves unchanged the 5 year payout period for distributions to a beneficiary that is not a "designated beneficiary," such as the plan participant or IRA owner's estate, or a trust that does not qualify as a "see-through" trust.

Roth Plans

Roth IRAs and plans are also subject to the new 10 year payout period. As under prior law, contributions to a Roth are not tax deductible – that is, they consist of after-tax dollars. However investment returns on the Roth assets while inside the plan, and distributions from the plan, are income tax-free. The accelerated 10 year payout period will result in the loss of tax-free growth, but since distributions are income-tax free, the SECURE Act will not have the same potential effect on the tax rates and brackets of the beneficiaries. Accordingly many financial advisors anticipate an increased interest in Roth conversions, particularly while there are favorable income tax rates, or if the tax bracket of the Roth IRA owner or plan participant is lower than that of the beneficiaries.

Planning

The SECURE Act will affect everyone with retirement assets. Its particular impact will differ depending on the circumstances and objectives of each individual or family. Those plan participants and IRA owners with Wills or Revocable Trusts that use conduit trusts for children or grandchildren must consider their options under the new law. In light of the 10 year payout period, consideration may be given to changing beneficiary designations from the conduit trust to the individual directly. For those plan participants and IRA owners who consider beneficiary spendthrift issues to be paramount, naming a non-conduit trust, typically referred to as an "accumulation trust," as beneficiary is an option. Accumulation trusts do not require the distribution of RMDs to the trust beneficiaries, but rather the trustee is permitted to retain the RMDs in the trust, with discretion as to the timing of distributions to the beneficiary. A downside to an accumulation trust that does not distribute out its income to the beneficiary on an annual basis is that the trust may be required to pay income tax on the RMDs at the high income tax rates imposed on trusts. Additionally, structuring an accumulation trust to qualify as a "see-through" trust is not in all cases practical, and those accumulation trusts that do not so qualify will be left with the short 5 year payout period to the trust. In any event, whether the payout period is 10 or 5 years, consideration must be given to planning for the potentially higher income tax costs associated with the accelerated payout period.

Please contact us to discuss how the SECURE Act affects your estate plan.

For more information on Meyer Suozzi's Wills, Trusts & Estates Law practice, click here.

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