"SECURE" ACT CHANGES RULES APPLICABLE TO MOST RETIREMENT ACCOUNTS

Effective January 1, 2020, the Setting Every Community Up For Retirement Enhancement (SECURE) Act makes important changes to the ways in which IRA and other retirement accounts can be distributed to beneficiaries.

Mandatory Age to Start Taking Distributions Increased for Certain Plan Owners

For plan owners born after June 30, 1949, the mandatory age to start taking distributions from most retirement accounts has been increased to 72 (from 70 ½).

Age Cap for Contributing to Traditional IRA is Removed

There is no longer an age after which a person cannot make contributions to traditional IRA accounts.

Life Expectancy Rule Replaced by Ten-Year Rule In Most Cases

Under the old rules, beneficiaries of retirement accounts were allowed to take distributions over their lifetimes, sometime referred to as a "Stretch payout."

Under the SECURE Act, the payout period for most designated beneficiaries of retirement plans is no longer the designated beneficiary's life expectancy. Instead, the designated beneficiary must withdraw all the funds in the plan by December 31 of the year that contains the tenth anniversary of the date of death of the plan participant. The funds can be withdrawn at any time during the ten-year period, and need not be withdrawn annually. Thus, the plan does not have to be withdrawn in equal installments, and it can be withdrawn in one payment at the end of the ten-year period. This ten-year rule applies where the plan participant dies after December 31, 2019.

Exceptions for Certain Designated Beneficiaries

For five types of designated beneficiaries (known as "Eligible Designated Beneficiaries") the old rules generally still apply. Thus, Eligible Designated Beneficiaries can still take distributions over their life expectancies. They are: (i) the surviving spouse; (ii) a minor child of the participant (but only until the child reaches the age of majority, at which point, the ten-year rule applies); (iii) a disabled beneficiary; (iv) a chronically ill beneficiary; and (v) a beneficiary who is less than ten years younger than the plan participant.

Rules Substantially Unchanged for a Surviving Spouse

Where the surviving spouse is the designated beneficiary, the rules are substantially the same. Thus, the surviving spouse still has the option to "roll-over" the benefits of the deceased spouse's plan into his or her own IRA or leave it in the deceased spouse's plan. In the case of a rollover, the surviving spouse is treated as the owner of the plan and does not have to start taking required minimum distributions until the surviving spouse reaches age 72. If the surviving spouse leaves the account in the deceased spouse's plan, the surviving spouse does not have to commence taking mandatory distributions until the end of the year in which the deceased spouse would have reached age 72, and the surviving spouse's life expectancy, recalculated annually, will be the basis for making distributions to the surviving spouse. Thus, the ten-year rule will not apply in either situation.

Rules Applicable to Minor Beneficiaries

Where a minor child of the plan participant is the designated beneficiary, the payout will be computed over the life expectancy of the minor, but only until the minor reaches the age of majority (generally, age 18 or 21, depending on state law). Thereafter, the minor must take out all the remaining funds from the plan by December 31 of the year that contains the tenth anniversary of the date when the beneficiary reached majority.

Disabled Beneficiaries and Chronically Ill Beneficiaries May receive their Distributions Over Their Life Expectancies

A designated beneficiary who is disabled may take distributions over his or her life expectancy. Similarly, a designated beneficiary who is "a chronically ill individual" may take distributions over his or her life expectancy. Certification requirements apply so that a beneficiary must be able to prove that he or she is "disabled" or "chronically ill" within the meaning of the statute. Upon the death of the disabled or chronically ill beneficiary, the life expectancy payout period terminates and the ten-year rule applies thereafter.

A Designated Beneficiary Who is Less than Ten Years Younger Than the Plan Participant

Where the beneficiary is less than ten years younger than the plan participant, he or she may take distributions from the plan over his or her life expectancy. Thus, where a plan participant designates his or her siblings as the beneficiaries of his or her retirement plan, and assuming that the siblings are less than ten years younger than the plan participant, each sibling will be able to withdraw his or her share of the inherited IRA over his or her life expectancy.

Note: As each sibling dies, his or her inherited IRA will become subject to the ten-year rule.

Old Rules Still Apply Where Beneficiary is Not a Designated Beneficiary

If a beneficiary is not a "designated beneficiary" as such term is defined under the old rules, the old rules still apply. Examples of beneficiaries that are not designated beneficiaries include: an estate, a charity or a trust that does not qualify as a "see-through" trust. Such beneficiaries must take distributions by December 31 of the year that contains the fifth anniversary of the date of death of the plan participant (known as the "five-year rule") if the participant died before the participant's required beginning date (now age 72) or over the deceased participant's remaining life expectancy immediately before the participant's date of death if the participant died after the required beginning date.

Trust as Beneficiary of Designated Plan

Under the old law, plan owners could use certain trusts, known as "see-through" trusts, if they wanted their intended beneficiaries to have the tax benefit of long deferrals of withdrawals while also limiting the actual amounts passing to beneficiaries each year, with control of all investments retained by a trustee. See-through trusts generally come in two types: "conduit trusts" which require the immediate distribution to the trust beneficiary of any IRA distributions the trust receives, and "accumulation trusts" which allow for the accumulation in the trust of any IRA distributions, but are taxed at the trust's generally higher tax bracket and only paid out to the beneficiary as and when the trustee determines.

Conduit trusts are generally less attractive under the new rules. Although the income beneficiary of the trust is still treated as the designated beneficiary of the plan, under the new rules, unless the beneficiary is an Eligible Designated Beneficiary, the plan must be paid out over the ten-year period described above. Thus, for example, where a conduit trust is used for the benefit of a minor beneficiary, the plan must be paid out by December 31 of the year that contains the tenth year anniversary of the date when the minor beneficiary becomes an adult. On the other hand, a conduit trust for a surviving spouse will still be paid out over the life expectancy of the surviving spouse, and may be drafted to ensure that the trust qualifies for the marital deduction for estate tax purposes.

Accumulation trusts are still a practical alternative for beneficiaries other than spouses. Such a trust allows funds that are withdrawn from an IRA account to remain in the trust, and so, provides a means to control the ultimate disposition of the funds. However, the trust is required to pay income tax at relatively high marginal rates upon receipt of the amounts required to be withdrawn from the IRA. Thus, there is a tax cost of using accumulation trusts.

What the New Law Means for Most People

For most people, the new law means that the beneficiaries of a retirement plan will now be taking their distributions over a shorter period than they had previously expected. As a result, there will be larger distributions taken over a shorter period of time. The beneficiary will be required to include the distributions in his or her taxable income for each year that the distributions are taken out. This could push a beneficiary into a higher tax bracket than he or she would have been subjected to under the old rules.

Using a Qualified Disclaimer to Avoid New Rules

Where an individual has died within the last nine months, the plan beneficiary may be able to disclaim his or her interest in the retirement account and thereby avoid the application of the new rules. For example, if a spouse is the designated beneficiary, and his or her children are the contingent beneficiaries who would have inherited if the spouse had not survived the deceased plan participant, the surviving spouse can disclaim the plan, causing the plan to be payable to the children. Assuming that the plan participant died prior to January 1, 2020, the old rules will apply and the children will be able to withdraw the inherited IRA amount over their life expectancies.

If you have any questions regarding the SECURE Act or wish to discuss the potential impact of the Act on your estate planning, please contact Peter L. Lese, any of the undersigned or your regular Warshaw Burstein attorney.

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