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Estate Planning Update January 2020 - Retirement Account Planning May Need to Be Reviewed Because of New Law

Stretch-Out of Inherited Retirement Accounts Largely Eliminated

The SECURE Act, a new law passed in late December that took effect January 1, 2020, eliminates the ability for many beneficiaries inheriting retirement accounts to "stretch" withdrawals over their lifetimes. You should review the impact of this new law on your retirement accounts, particularly if you currently designate a trust as beneficiary.

Formerly, after the death of the person who established an individual retirement account (IRA) or other tax-deferred retirement account (including a 401(k) or 403(b), among others, whether conventional or Roth plans), the balance in the account often could be withdrawn over the life of the beneficiary, stretching out the income tax deferral for decades.

Now, if the original account owner dies in 2020 or later, retirement accounts must be withdrawn in full by the end of the 10th year following the account owner's death, with a few exceptions.

In the case of retirement benefits payable to trusts, unless the trust properly accounts for the new law, the withdrawal period may be even shorter. The trust terms may have to be changed in order to allow the application of the 10-year withdrawal rule rather than an even less favorable rule.

Two benefits of the new law are that the age for beginning required minimum distributions is now 72 years old, instead of 70½ and that there is no longer an age at which you must stop making IRA contributions, as long as you are still working. These changes allow more tax-free growth in the account. The unfavorable withdrawal rule changes apply only to beneficiaries of your accounts after your death.

WHAT STEPS SHOULD YOU TAKE IN RESPONSE TO THIS CHANGE IN THE LAW?

- ☐ Review your beneficiary designations and the current balances of your retirement accounts.
- ☐ Particularly if you have retirement plans payable to a trust (either as primary or contingent beneficiary), you may wish to contact your Day Pitney estate planning attorney to review whether an amendment to the trust or changes to your beneficiary designations are in order.
- ☐ Because the new law affects the income taxation of retirement plans, you may wish to contact your financial adviser to discuss the impact of these changes on your income tax planning.

Stretch treatment may still be available for these beneficiaries:

- the surviving spouse of the original account owner;
- a child of the original account owner who has not reached the age of majority (but only until that child reaches majority);
- a person who is no more than 10 years younger than the original account owner; or
- a disabled or chronically ill person.

At the death of any of these beneficiaries (or in the case of the minor child, when the child reaches majority), the stretch treatment ends and the account balance must be withdrawn by the end of the 10th year following that date. A trust for the benefit of one of these beneficiaries can also qualify for stretch treatment but only in limited circumstances.

Some frequent questions and answers follow.

Q. **Does this affect the required payouts from my retirement account during my lifetime?**

A. The new law raised the age for starting required distributions to 72 and the payout tables for an account owner are expected to be revised to reduce required minimum distributions during an owner's lifetime. The withdrawal rule changes apply only to beneficiaries of your accounts after your death.

Q. **Has anything changed if my spouse is named individually as the first beneficiary?**

A. If your spouse is named as the primary beneficiary, nothing has changed during your spouse's lifetime. A spouse can still roll over the account and withdraw it over his or her lifetime. In addition, if the spouse chooses not to roll over the account, the spouse can still stretch withdrawals over his or her lifetime. You should still review who is named as the contingent beneficiary.

Q. **What has changed if my retirement account is payable to a trust for my spouse?**

A. It depends on the trust terms. Stretch treatment could be available if the trust terms provide for all withdrawals from the retirement account to be paid to your spouse immediately. Care should be taken before taking advantage of this stretch option to be sure it is consistent with your overall planning objectives.

Q. **If my retirement account is payable to a trust for my minor child, can withdrawals be spread out until the 10th year after the child reaches majority and then held in trust?**

A. Unfortunately, no. If distributions to a trust are stretched out to take advantage of the special rule for minors, the trust has to pay out the entire retirement account by the end of the 10th year after the child reaches majority. This feature means it may be better to accept the 10-year rule, under which the withdrawals can be retained in trust as originally planned.

Q. **Are there any planning opportunities with this change?**

A. The change appears in the "Revenue" section of the new law, indicating that it was intended to raise tax revenue and not provide tax benefits. That said, one feature of the 10-year rule is that distributions can be taken at any time in the 10-year period — not necessarily spread evenly across the 10 years — so there may be some opportunities for strategic decisions about when during that period withdrawals are taken, say, to take advantage of years in which the beneficiary has higher deductions or lower outside income.

Q. **How else does this impact planning for my retirement account?**

A. The loss of the stretch treatment for most beneficiaries means income tax will be paid on the full value of the retirement account sooner (unless the plan is a Roth plan, which is not subject to income tax). Because the withdrawals will typically be made over a much shorter period, the tax will be paid at higher rates (in a higher tax bracket) than under prior law. To minimize or eliminate the effect of these higher rates, account owners may wish to consider leaving retirement accounts to charities or to charitable remainder trusts. They may also wish to consider Roth IRA conversions during lifetime, so the income tax is paid during the account owner's lifetime and there is no income tax due on the account distributions to the beneficiaries.

Authors



B. Dane Dudley
Partner

West Hartford, CT | (860) 313-5752

bddudley@daypitney.com



Darren M. Wallace
Partner

Stamford, CT | (203) 862-7874

Greenwich, CT | (203) 862-7800

dmwallace@daypitney.com



David L. Silvian
Partner

Boston, MA | (617) 345-4655

dsilvian@daypitney.com