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SECURE ACT—Game Changer for Estate Planning With Qualified Retirement Benefits

The new provisions of the SECURE Act, which were enacted on Dec. 20, 2019, and become effective as of Jan. 1, 2020, change a key factor that goes into the planning process. The SECURE Act stands for “Setting Every Community Up for Retirement Enhancement.”

By **Rebecca Rosenberger Smolen and Amy Neifeld Shkedy |** January 02, 2020

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In articles that were published in the Legal Intelligencer in September and October 2014, we shared our thoughts on estate planning and estate administration with qualified retirement benefits, which include both IRAs and qualified retirement plan benefits, such as 401-K accounts (collectively referred to herein as tax deferred retirement accounts). Until now, not much had changed in the landscape that impacts our thinking for planning with this type of asset. However, the new provisions of the SECURE Act, which were enacted on Dec. 20, 2019, and become effective as of Jan. 1, 2020, change a key factor that goes into the planning process. The SECURE Act stands for "Setting Every Community Up for Retirement Enhancement."

Prior to the enactment of the SECURE Act, one of the valuable benefits of careful estate planning with tax deferred retirement accounts was to preserve the tax deferral benefit of these assets over the life expectancy of children, or even better, grandchildren of the deceased funder of the account (the participant) if the beneficiary designation form was properly completed. The economic value of that life expectancy "stretch-out" could be very significant, so much so that at times it could be more valuable than leaving assets without any built-in taxability to the same beneficiaries. Careful planning was essential to ensure that what is technically known as a "designated beneficiary" was properly named to achieve the most beneficial stretch-out. Not all named beneficiaries qualify as "designated beneficiaries." For example, if an estate (as opposed to a revocable trust) is named as, or is otherwise deemed to be, the beneficiary, the payout options (which could be a required five-year payout) were generally less favorable than the payout over the life expectancy of an individual designated beneficiary. Those days of careful planning to obtain the maximum life expectancy stretch-out are now over for the beneficiaries of a participant who dies on or after Jan. 1, 2020.

Now, in essence, the five-year payout rule that applies when there is no designated beneficiary for a tax deferred retirement account has been unleashed in all cases. However, when there is a designated beneficiary properly named, instead of the duration of the payout period being five years, it is now 10 years. This is compared to a payout period available under the prior regime of as long as 81.6 years for a 1-year-old beneficiary, or 43.6 years for a 40-year-old beneficiary.

We agree with several commentators who have noted that, under this new paradigm,

using a “conduit” trust as beneficiary for IRAs will no longer make sense in most instances, since it would mean that the entire tax deferred retirement account will necessarily be distributed to beneficiaries of the trust by the end of a 10-year period. That might be palatable for older beneficiaries, say, those over 40 or 50. But, for younger beneficiaries, in many instances, such a truncated payout period might not be desirable to the participant. Moreover, even for the older beneficiaries, it might not be desirable to lose the creditor protection and estate tax “shelter” benefits of a trust, for what can be a significant portion of an inheritance, after the 10-year period. It’s not just about the maturity of the beneficiary.

One important planning option that will now provide greater utility than in the past for planning in this area is the charitable remainder trust (CRT). By naming a CRT as beneficiary of a tax deferred retirement account, the beneficiaries will be able to secure a stretch out that will mimic what was available before the SECURE Act changes. In simple terms, the way a CRT works, an annuity or unitrust amount is paid out for a term of years, or the life expectancy, of noncharitable beneficiaries and then what remains at the end of the payout period is passed out to the charitable remainder beneficiary. The key is that the noncharitable beneficiaries are only subject to income tax on the tax deferred funds received by the CRT as they receive a portion of such funds in distributions to them (and the composition of distributions to beneficiaries are generally characterized for tax purposes on a LIFO basis). The charitable remainder beneficiary must receive at least 10%, on a present value basis, of the assets contributed to the CRT. This technique works best when the applicable federal interest rates for valuing the remainder interest are higher than they are currently.

It should be noted that the SECURE Act’s replacement of the prior stretch-out opportunity with a required 10-year distribution payout has a few exceptions. It does not apply to a participant’s surviving spouse, a minor child of the participant (but only while still a minor as determined under applicable state law), a disabled or chronically ill beneficiary, or a beneficiary who is not more than 10 years younger than the participant.

On a positive note, the SECURE Act delays the required commencement of minimum required distributions for the participant from age 70.5 to age 72. Also, once that

"required beginning date" is reached, unlike in the past, the Participant may continue to make contributions to an IRA (as long as the Participant is still receiving earned income, of course).

As the years go by, we find that tax deferred retirement accounts provide a larger and larger component of the asset base for many clients. So, this significant change in the law will reduce the tax benefits available for many of their heirs when they die. The good news for those heirs, though, is that, at least for now, with a rise in the federal estate tax exemption from $600,000 to more than $11 million over the last 20 or so years, along with the introduction of the portability concept for the exemption, they are very likely still coming out ahead.

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