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The SECURE Act: Major Changes Coming to Retirement Accounts in 2020

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On December 20, 2019, the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act") was enacted. The SECURE Act makes several important changes to the rules governing retirement accounts, effective January 1, 2020. Some of these changes are positive for retirement account owners ("owners"), allowing them to contribute longer to their retirement savings and delay the age by which they must begin taking withdrawals. However, other changes substantially curtail the longstanding benefits of leaving inherited retirement accounts to beneficiaries after the owner's death.

One of the most significant changes made by the SECURE Act that impacts estate plans is its limitation of the so-called "stretch-out" rules for most, but not all, beneficiaries of inherited retirement accounts. The ability to stretch out inherited retirement account withdrawals over a beneficiary's lifetime can confer important income tax benefits, as it both preserves the assets that can grow income tax-free within the retirement account and also minimizes the amount of each withdrawal, which, in the case of a traditional retirement account, is subject to ordinary income tax. Although this is not technically a "tax increase", the SECURE Act's new rules can accelerate income recognition for certain beneficiaries of inherited retirement accounts by compressing the time over which they must withdraw the accounts. This change in the law is projected to generate $15.7 billion in additional tax revenue over 10 years (Congressional Budget Office estimate).

Previously, the rules governing inherited retirement accounts allowed for the annual withdrawal of the account to be stretched out over the lifetime of certain beneficiaries known as "designated beneficiaries." Under those rules only individuals or so-called "see-through" trusts with discernible individual beneficiaries would qualify as designated beneficiaries. Under the SECURE Act, beneficiaries of an inherited retirement account (whether Roth or traditional) now fall into three classes, which dictate the timeframe over which the inherited account must be withdrawn.

1. The most preferred beneficiaries are now called "eligible designated beneficiaries." These individuals include a surviving spouse, a minor child (while a minor), an individual who is disabled or chronically ill, and an individual who is not more than 10 years younger than the owner. These persons all may continue to withdraw from an inherited retirement account over their life expectancies.
2. The next most preferred beneficiaries are still referred to as designated beneficiaries, and they are individuals who do not fit in the preceding category. These would include adult children, grandchildren of any age, siblings and see-through trusts for the benefit of designated beneficiaries. A member of this class now must withdraw the entire inherited retirement account over 10 years and no longer can stretch out withdrawals over his or her own life expectancy. Further, an individual who was an eligible designated beneficiary

because he or she was a minor child at the time of the owner's death will automatically become subject to the 10-year rule upon reaching adulthood. An account subject to the 10-year rule does not need to be withdrawn ratably over that period, but must be completely withdrawn by the end of the period.

3. Beneficiaries who are not eligible designated beneficiaries or designated beneficiaries, such as charities, estates and non-see-through trusts, still must withdraw an account over 5 years if the owner's required minimum distributions had not yet begun at the time of the owner's death, or over the owner's remaining life expectancy if those distributions had begun at the time of the owner's death.

These changes to the withdrawal rules generally apply to both traditional and Roth inherited retirement account distributions made to beneficiaries of account owners who die after December 31, 2019. In other words, the old lifetime stretch-out rules will continue to apply to inherited retirement account beneficiaries who are currently required to make withdrawals. However, if such a beneficiary dies after January 1, 2020, the beneficiary's own beneficiaries are subject to these new withdrawal rules.

In more positive news, the SECURE Act pushes back the age at which the owner of a traditional individual retirement account must begin making withdrawals. An IRA owner has traditionally needed to begin taking withdrawals by April 1st of the calendar year following the year in which the owner reaches age 70 ½. This is known as the "required beginning date". Under the SECURE Act, the age that triggers the required beginning date has increased to 72, meaning that an account owner will be able to defer taking withdrawals from an IRA even longer. The owner of a 401(k) account can still delay beginning withdrawals until his or her retirement, if later than the time when he or she reaches age 72.

The SECURE Act also now permits deductible IRA contributions to be made beyond age 70 ½. This creates an incentive for older working individuals to continue making contributions to their retirement plans.

The SECURE Act largely preserves the rules for the IRA charitable rollover. This provision allows an individual who has reached age 70 ½ to make contributions directly to certain types of charities each year of up to $100,000 from his or her IRA. Any such contribution counts towards the amount that the owner would otherwise be required to withdraw from the IRA but is excluded from the owner's gross income – creating, effectively, a 100% deduction for the amount passing to charity regardless of whether the taxpayer itemizes deductions. However, the amount that may be transferred to charity will now be reduced by deductible IRA contributions made by the IRA owner after reaching age 70 ½.

Individuals with large retirement accounts should consult with their attorneys about how the SECURE Act impacts their planning, especially if retirement plans are to be left in trust for individual beneficiaries. Many clients choose to leave assets in trust for beneficiaries in order to take advantage of creditor protection and transfer tax benefits. Before the SECURE Act, a common approach to creating a "see-through" trust that qualified as a designated beneficiary was to create a so-called "conduit trust" that would pass out the required minimum distribution to the beneficiary each year over the beneficiary's life expectancy. The elimination of the stretch out for these beneficiaries may call for clients to update or rethink how they will deal with retirement plan assets in their estate plans.

Moreover, the reduced ability for younger generations to defer income taxes on traditional retirement accounts makes them even more attractive assets to fund charitable giving at death. Withdrawals from traditional retirement accounts by individual beneficiaries are subject to ordinary income tax, whereas distributions of retirement accounts to charities are income tax-free. This makes a retirement account more valuable in the hands of a charity than a family member, assuming that other assets exist to be left to family.

The SECURE Act will impact each individual in a different way. For more information, please contact your Private Client & Trust or Tax attorney at Goulston & Storrs PC.