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The SECURE Act and the Impact on your Retirement and Estate Planning - *Women Lawyers in Bergen*

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The Setting Every Community Up for Retirement Enhancement Act (the "SECURE Act"), part of the Further Consolidated Appropriations Act, 2020, was signed into law on December 20, 2019. Effective as of January 1, 2020, the SECURE Act makes significant changes to the laws governing many qualified retirement plans and individual retirement accounts that can have substantial impact on your retirement planning, and estate planning and related documents. In order to fully appreciate how the SECURE Act changes the face of retirement and estate planning, it is important to understand the prior rules as they are still partially in effect. Therefore, this Article will focus its attention on some of the key changes brought about by the SECURE Act and the interplay with the prior law, with specific attention to the impact on retirement and estate planning, including changes to allowable contributions to Individual Retirement Accounts ("IRAs") and Required Minimum Distributions ("RMDs"), the impact on "stretch" distributions from IRAs and qualified plans, and the impact on trust planning for retirement assets.

Contributions to Individual Retirement Accounts (IRAs)

As a general rule, any individual with "earned income" (as defined by the Internal Revenue Service), or a non-working spouse of an individual with "earned income," can contribute annually to an IRA. Before the SECURE Act, an individual was prohibited from making an annual contribution to an IRA beginning in the tax year that he or she turned 70 . However, the SECURE Act removed this age restriction for contributions to IRAs beginning in 2020. Therefore, as long as an

individual continues to have "earned income," regardless of that person's age, he or she can make annual contributions to an IRA.

For the year 2020, assuming an individual over the age of 50 has "earned income" that supports the maximum allowable contribution to an IRA, he or she is able to contribute a maximum of $7,000, and a married couple can contribute a maximum of $14,000. This ability to continue to maximize the funding of a tax-deferred retirement asset after the age of 70 provides a valuable income tax and savings tool to individuals nearing retirement. This modification in the law is presumably intended to address increased life expectancy and extends the availability of this favorable income tax planning tool to the many individuals that have decided to retire at a later age.

Required Minimum Distributions (RMDs)

Federal law requires the owner of a tax-deferred retirement account (such as a traditional IRA) and the participant in an employersponsored retirement plan (such as a 401(k), 403(b) and 457), or a selfemployed retirement plan (a SEP), to take annual RMDs. Generally, annual RMDs are calculated based upon the value of the tax-deferred retirement account (s) and the account holder or plan participant's lifeexpectancy pursuant to IRS published tables. If an individual has more than one tax-deferred retirement account or participates in more than one plan, the RMD is calculated on the aggregate value of such accounts, but the owner/participant can choose to take the RMD from one or all of those accounts, as long as the annual RMD is met.

Prior to the effective date of the SECURE Act, the owner of a tax-deferred retirement account and/or plan participant was required to begin taking annual RMDs during the year in which he or she turned 70 (with the ability to delay the distribution of the first RMD until April 1st of the following year), and each subsequent year before December 31st. However, the SECURE Act changed the required age at which a tax-deferred account owner/plan participant must take annual RMDs to age 72. Despite this extended age requirement, the first year RMD may still be delayed until April 1st following the year that the individual attains 72 years of age, and each subsequent annual RMD must be taken by December 31st. If the account owner/plan participant reached 70 in or before 2019, the prior rules relating to annual RMDs apply, and if he or she reaches 70 in 2020 or later, the SECURE Act rules apply.

Annual RMDs are taxable income to the owner of the taxdeferred account(s) and/or plan participant. Therefore, this extended age requirement for required annual RMDs allows these assets to continue to grow in a tax-deferred manner for an extended period of time. Perhaps the above-discussed ability to continue to fund such accounts/plans after the age of 70 , coupled with the ability to wait longer to pull assets out, will help to increase assets available for retirement for those individuals that do not need to tap into these assets before the age of 72.

Furthermore, since individuals will not be required to start taking RMDs until the age of 72, this almost 2-year extension also provides owners of traditional IRAs additional time to convert
these accounts to ROTH IRAs, which are not income taxable upon distribution and have no RMDs. A ROTH IRA

conversion allows the holder of a traditional IRA to convert income taxable assets in the traditional IRA to a ROTH IRA, pay income taxes at ordinary federal and state rates at the time of the conversion, and move the assets into a vehicle where those assets can grow income-tax free. If the income taxes paid at the time of conversion to a Roth IRA are paid from other assets, the assets used to pay the tax are removed from the taxpayer's potentially taxable estate. There are many considerations when deciding whether to convert a traditional IRA into a ROTH IRA, but, if it makes sense depending on the account owner's circumstances, it may be easier to do before he or she is required to take RMDs.

Impact on "Stretch" Distributions from IRAs and Qualified Plans

One of the most significant changes relating to IRAs and qualified assets, particularly as it relates to estate planning, deals with the income tax treatment of those assets on the death of the account owner/plan participant. Generally, if the owner/plan participant is married, he or she will leave the retirement asset to his or her spouse. If the owner/plan participant is not married, it is common to leave such assets to your lineal descendants. In any event, however, most people prefer to make these transfers as a result of the death of the account holder/plan participant in the most tax effi cient manner through the utilization of a "stretch" for non-spousal beneficiaries.

A "stretch" as it related to an inherited IRA or qualifi ed plan under pre-SECURE Act law allowed a designated benefi ciary to take distributions over that benefi ciary's life expectancy, resulting in a favorable income tax deferral. Specifi cally, following the death of an IRA owner or a qualifi ed plan participant, tax-deferred assets passing to a named qualifi ed benefi ciary (a "designated benefi ciary") would be payable over that designated benefi ciary's lifetime. Specifically, the designated benefi ciary would receive RMDs based upon his or her life expectancy, which, in many cases, was much longer than the life expectancy of the account owner/plan participant, which allowed a small amount to be distributed each year while the remaining account balance could continue to grow income tax-free. Prior to the SECURE Act, this stretch was achievable through the use of an inherited IRA or a properly structured "see-through" trust (such as a "conduit trust" or an "accumulation trust" , both discussed further below). However, the SECURE Act's introduction of the 10-year rule greatly impacts this planning opportunity for many beneficiaries.

For many individuals inheriting an IRA or qualifi ed plan of an individual dying on or after January 1, 2020, the SECURE Act will now require that all tax-deferred assets be distributed by the end of the tenth year following the death of the account owner/plan participant, with some exceptions (eligible designated benefi ciaries, discussed further below). It is important to note that distributions to nonindividual beneficiaries of IRAs and qualified plans remain unchanged by the SECURE Act. The law before the SECURE Act accelerated the payout period to such non-qualified beneficiaries, such as an estate, trust (excluding conduit trusts), entity, or a charity, be distributed by the end of the fifth year following the death of the account owner/plan participant, which remains the same.

The exceptions to the 10-year rule include eligible designated beneficiaries as defi ned by the SECURE Act, which includes the account owner/plan participant's surviving spouse, a minor child of the account owner/plan participant (not a grandchild), a disabled individual as defi ned in Internal Revenue Code Section 72(m)(7), a chronically ill individual as defi ned in Internal Revenue Code Section 7702B(c)(2), and an individual not more than 10 years younger than the account owner/plan participant. These eligible designated beneficiaries may withdraw IRAs and plan assets over their life expectancy, except for the minor child of the owner/participant to whom the 10-year rule applies upon such child reaching the age of majority (beginning with the year after that child reaches the age of majority). Th erefore, adult children and more remote lineal descendants of an account owner/plan participant who do not fall under this list of exceptions must take distributions within this tenyear period.

Impact on Trust Planning for Retirement Assets

While no distributions of IRAs or qualifi ed plan assets need to be made during the ten-year period to those individuals that do not fall within the above exceptions, the requirement that all such assets must be distributed by the end of the tenth year following the owner/participant's death may not align with the planning objectives and/or the owner/participant's existing planning documents. Many individuals' largest assets include their tax-deferred retirement funds, and, prior to the SECURE Act, it was quite common for an individual interested in protecting this large asset (with an eye on income tax deferral) to direct the asset to be held in a see-through trust upon his or her death. Th e most common type of such trust being a conduit trust.

A conduit trust is structured so that the beneficiary of the trust would annually receive the RMD, which was calculated on his or her life expectancy and would flow through the trust, while the principal of the asset remained protected in the trust. Since the goal in this planning was to protect the asset, potentially, for the beneficiary's lifetime, and now all tax-deferred assets must be paid out by the end of the ten-year period (unless the trust is for the benefit of an eligible designated beneficiary), the conduit trust structure may no longer achieve its intended goal of protecting the asset or the intended beneficiary.

An alternative to the conduit trust is the accumulation trust. Unlike the conduit trust, the accumulation trust structure does not force out the payment of the RMD each year but, rather, protects
both the income and principal of the tax-deferred asset within the trust giving the Trustee the discretion to decide whether to pay out annual RMDs to the trust benefi ciary or retain them in the trust. While the accumulation trust will still be subject to the 10-year rule (unless the trust is for the benefit of an eligible designated beneficiary) and potentially less income tax effi cient, if the primary objective is to protect the assets from a benefi ciary's creditors or the beneficiary's own irresponsibility for a period of time that is longer than the 10 year required payout, then an accumulation trust with discretion that allows the trustee of such trust, depending on the circumstances, to make more tax-efficient distributions, will likely be a safer approach.

Regardless of how it is structured, if an individual has designated a trust as the benefi ciary of an IRA and/or qualifi ed assets, it is imperative that he or she review the trust's structure and the implications of the SECURE Act on such trust with an estate planning attorney to ensure that the stated estate planning goals can still be realized in an efficient and flexible manner. It is also imperative that benefi ciary designations on such assets be carefully reviewed to ensure coordination with the estate and related planning goals, particularly in light of the substantial changes brought about by the SECURE Act.

Conclusion

The SECURE Act includes many changes that will have a significant impact on your retirement and estate planning requiring a proactive approach to ensure that your goals are achieved. It is
imperative that you review your estate planning to ensure that your goals align with the planning that is in place. Additionally, specifically as it relates to your IRAs and qualifi ed assets, it is very important to review the benefi ciary designations on such tax-deferred assets to make sure that they align with the new rules and your estate and related planning goals.