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Changes to Retirement Savings After the SECURE Act of 2019

On December 20, 2019, President Trump signed the Setting Every Community Up for Retirement Enhancement Act (the "SECURE Act"). The underlying premise of the SECURE Act was to enhance individual retirement savings. It also professes to simplify the administration of our retirement system. Some of the basic features of the new law include:

- Increasing the beginning age for mandatory withdrawals from a qualified retirement plan[1] from 70½ to 72;
- Repealing the maximum age for contributions to a traditional IRA;
- Limiting the "stretch" IRA to 10 years;
- Allowing individual small businesses to group together in establishing retirement plans which will benefit employees of the separate companies;
- Changing the requirements for part-time employees to be eligible to participate in an employer's plan;
- Permitting employers to automatically enroll employees in the company's retirement plan (substituting an "opt-out" system for the current system which requires an employee to take affirmative action to join his employer's plan);
- Allowing penalty-free distributions from qualified retirement plans for births and adoptions.

[1] The term "qualified retirement plan" as used herein includes all private and employer-sponsored plans which allow individuals to defer income tax liability on monies specifically set aside for retirement such as IRAs, 401Ks, 403(b)s, 457s, etc.

According to the Insured Retirement Institute, the SECURE Act addresses "a deepening crisis where too few Americans are saving sufficiently to ensure an adequate income for their retirement years." The Act resulted from a widespread belief that these reforms will increase individual *access* to retirement plans in the workplace, and thus expand retirement savings of all Americans.

From an estate planning perspective, one of the most important features of the Act is the limitation of the "stretch" IRA. The term "stretch IRA" refers to an inherited retirement account being able to be drawn down over the life expectancy of the beneficiary. Both the old and new rules do not apply to a qualified retirement account having a spouse as beneficiary. When the spouse is beneficiary, the spouse can make an election to treat the IRA as his or her own, and even commingle it with an existing IRA of the spouse, through what's called a "spousal rollover." However, when a child or other individual is named as beneficiary, the account is treated as an "inherited IRA" and very different rules apply regarding distribution and taxation. This is where the SECURE Act made significant changes.

Under the prior law, assuming certain criteria existed, when the plan participant died, the required minimum distribution (RMD) amount could be recalculated based on the life expectancy of the beneficiary. Although the beneficiary had to begin taking distributions immediately, the distributions could be drawn out over the beneficiary's life expectancy. This meant that if the beneficiary was younger than the account owner, the IRA would be paid out over a longer period of time, thus providing the opportunity for maximum deferral on the payment of income tax, accordingly referred to as a "stretch" IRA. The stretch permits the funds to be kept inside the inherited IRA for a much longer term, thus permitting tax-free compounding of the funds inside the account. It is an excellent opportunity for wealth accumulation, even though the beneficiary is required to take minimum distributions and pay tax on the amounts withdrawn.

Under the new law, the maximum "stretch" period for non-spousal beneficiaries is limited to ten (10) years. The beneficiary has the option of taking the annual RMDs over the 10-year period or waiting until year 10 and withdrawing the entire principal amount. There are only a couple of exceptions to the 10-year distribution rule: 1) if the beneficiary is a minor child of the plan participant, the 10-year period will start once the

child reaches the age of majority; and 2) if the beneficiary is disabled or "chronically ill," or if the beneficiary is no more than 10 years younger than the plan participant, the beneficiary may still take distributions over his/her life expectancy.

So, what does this mean in terms of your planning? Now is the time to review your beneficiary designations. If a trust or trust share is listed as beneficiary of any qualified plan assets, you may need to meet with your attorney to determine if that is still the best course of action or if changes should be made to the plan or to the trust. Many plans provide for such assets to pass through a trust for purposes of beneficiary creditor protection. However, because the income tax rate structure for trusts is so high, trusts often provide that annual RMDs pass out of the trust directly to the beneficiary. Since the RMDs will now be significantly larger, this may no longer accomplish your goals.

There are still options which may help avoid some of the significant income tax consequences created by these new laws which you should discuss with your attorney, such as:

•If your goal is asset protection for a beneficiary, consider restructuring your trust to provide for the accumulation of RMDs; the income tax liability will be higher, but holding the assets in trust will ensure creditor and spendthrift protection for your beneficiary;

•Consider converting traditional IRAs to ROTHs; paying the taxes now can significantly reduce the overall future tax liability of your beneficiaries;

• Consider leaving retirement assets to charity as charities do not pay income tax; this strategy is particularly beneficial if you already have charities included in your estate plan, and is worth considering even if you don't;

•Create a Charitable Lead Trust funded with the proceeds of a retirement plan; the charitable lead trust allows the donor to make a gift to charity from the trust over a period of years and have the balance distributed to named beneficiaries tax-free upon termination of the lead period;

•Purchase life insurance to cover the anticipated tax liability (i.e. reduction in value of the qualified plan assets passing to beneficiaries); life insurance can also be used to "make up" the difference in a beneficiary's inheritance if the qualified plan assets, or a portion of them, are allocated to charity.

Whether or not the changes made by the SECURE Act will encourage more Americans to save for retirement will not be determined for many years. However, there is no dispute that the changes to the stretch IRA provisions will significantly increase tax revenue to the federal government. It is estimated that as much as a third (1/3) or more of an inherited IRA could be consumed by taxes, and this will increase further when taxes rise across the board upon expiration of the Tax Cuts and Jobs Act in 2025. According to the Congressional Research Service, the elimination of the stretch IRA could generate as much as $15.7 billion in additional tax revenue.

As the potential implications of these changes are different for everyone, we recommend you seek assistance immediately. Now is the time to review your estate plan to determine how elimination of the stretch IRA will impact you, your estate plan, and your beneficiaries.

This publication is intended for general information purposes only and is not to be construed as providing legal advice. You must consult an attorney to discuss how the laws apply to your specific situation and how to best implement a plan that will meet your individual goals and objectives. If we can be of assistance in that regard, please call us at (757) 969-1900 to schedule a consultation appointment.