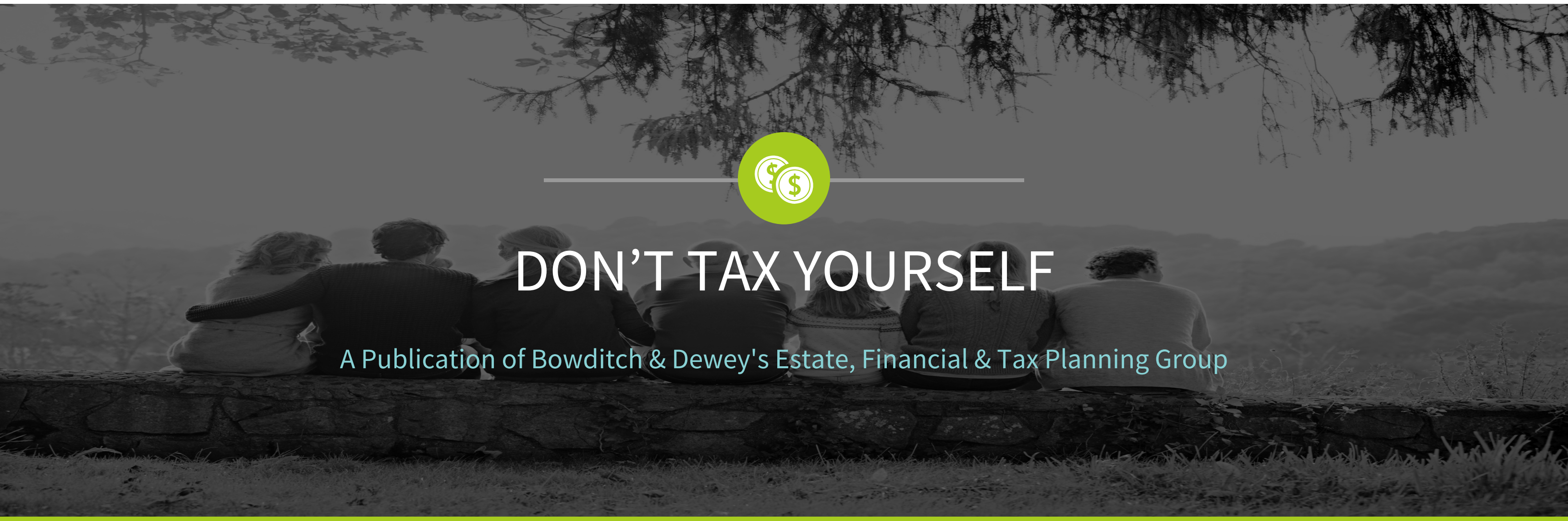

The SECURE ACT Eliminates "Stretch" Distributions for Certain Beneficiaries and Impacts Estate Planning

BY EILEEN Y. LEE BREGER • JANUARY 22, 2020

Signed into law on 12/20/19, the SECURE Act ushers in major changes to the treatment of IRAs and certain retirement benefits, especially in the estate planning context. The new law eliminates the ability of a beneficiary who inherits a retirement plan to "stretch" distributions over his or her lifetime. For many years, the "stretch" strategy was a popular way for beneficiaries to take advantage of valuable income tax deferral and tax-free growth inside the plan by taking only a small required minimum distribution each year. The SECURE Act requires that beneficiaries, with certain exceptions for surviving spouses, minor children, beneficiaries not more than 10 years younger than the initial plan owner, and disabled or chronically ill individuals, to withdraw the entire balance of the plan within 10 years after the plan owner dies.

Many people designate a trust as the beneficiary of a retirement plan in their estate planning. In light of the significant changes to the distribution rules, people should sit down with their estate planning attorney to determine whether amendments should be made to a trust that will one day administer a retirement account. Many trusts have been drafted with "conduit trust" provisions and under prior law such trusts qualified for "stretch" treatment based on the life expectancy of the oldest trust beneficiary. A conduit trust typically passes through annual minimum distributions to the beneficiary while protecting the bulk of the asset in trust from the beneficiary's creditors or a divorcing spouse or from a beneficiary with spendthrift tendencies. Under the SECURE Act, a conduit trust will require the distribution of the full balance of the retirement plan asset to the beneficiary by end of a 10-year period following the death of the original owner. If a large portion of the trust holds retirement assets, then the 10-year payout rule will undermine the protective purposes of a trust that is intended to manage assets for the beneficiary's lifetime.

In some cases, a trust may need to be changed from a conduit trust to an "accumulation trust," a type of trust which does not pass through plan distributions to a trust beneficiary. Any plan distributions are retained in trust and distributed in the trustee's discretion. Even with an accumulation trust, the retirement plan will have to withdrawn by the trust within 10 years and taxes paid. However, the large lump sum distribution from the plan can be held in trust and not automatically paid out to the beneficiary, providing for the continued protection of assets.

An accumulation trust may result in higher overall income taxes, especially if the trust waits until the 10th year to withdraw the retirement plan. The trust will be responsible for the income taxes and since a trust faces compressed income tax brackets that income may be pushed into the highest tax bracket. For example, a trust begins paying income taxes at the highest marginal rate of 37% once the trust's taxable income exceeds $12,950, whereas a married couple filing jointly is not subject to the highest rate until their taxable income exceeds $622,050. One potential way to lessen the sting out of the income tax hit might be for the trust to take distributions each year during the 10 year period (rather than waiting until the 10th year) in order to spread out the taxable income and stay within lower tax brackets.

Charitably-inclined individuals who still want to provide a beneficiary with a stream of income may want to consider designating a charitable remainder trust (CRT) as the beneficiary of a retirement plan. With CRT planning, a parent could name a child as the lifetime income beneficiary of the trust and at the child's death, the remainder of trust assets would be paid to the donor's chosen charity.

With this monumental change in the law, those who are wise will be sure to meet with their adviser to discuss how the new SECURE Act impacts their estate planning.