Special Estate Planning Alert

December 26, 2019 **|** by Gary Botwinick, Matthew Rheingold

On December 20, 2019, President Trump signed into law the Setting Every Community Up for Retirement Enhancement Act, or SECURE Act. Beginning on January 1, 2020, the SECURE Act implements substantial policy changes to retirement accounts. The Act is designed to increase retirement savings, including (i) making it easier for small businesses to band together to sponsor retirement plans, (ii) providing legal protection for employers offering annuities in retirement plans, (iii) requiring businesses to permit long-term, part-time workers to become eligible for retirement benefits and (iv) increasing the age to begin withdrawing required minimum distributions ("RMDs") from 70 ½ to 72. To help pay for all of these retirement reforms, the SECURE Act requires that most non-spouse beneficiaries of retirements accounts must withdraw the entire account within ten-years of the original account owner's death, rather than over the course of the beneficiary's expected lifetime as determined by the IRS (what was known as the "Stretch IRA").

The SECURE Act also implements other changes, including permitting money from 529 college savings plans to be utilized toward student-loan debt (with a $10,000 limit) and allowing employees with a 401(k), IRA or other retirement plan to withdraw up to $5,000 from their account, without the typical 10% early-withdrawal penalty, to cover the cost of having a baby or adoption (however, the employee will still owe income tax on the distribution unless they repay the funds).

Five highlights to know about the legislation:

Commencement of Required Minimum Distributions at Age 72

Starting on January 1, 2020, the Act increases the age at which an individual is required to start withdrawing money from his or her traditional retirement accounts from age 70 ½ to age 72. Although an individual is permitted to withdraw money from his or her retirement account at any time after the age of 59 1/2, penalty free, the account owner will now be *required* to commence withdrawing any funds at age 72 (his or her required minimum distribution). The distribution amount is based upon the account owner's life expectancy, with the intent of having the owner gradually withdraw his or her retirement account balance over time.

Despite the changes in the law, individuals who have already begun withdrawing their RMDs should continue as scheduled under current rules. Anyone who will turn 70½ on or after January 1, 2020 will be subject to the new rules and will now have an extra year and a half before they will be required to start withdrawals.

Inheriting an IRA – the New 10-Year Rule

Following the death of a retirement account owner, the law requires the beneficiary to make withdrawals of the account under specified rules which are dependent upon the identity of the beneficiary. Current law allows the surviving spouse named as a beneficiary of an IRA to treat the IRA as his or her own (known as a "Spousal Rollover") and does not impose rules for withdrawal which are different than the rules that would apply if the surviving spouse was the original owner of the account. However, the same favorable tax treatment is not afforded to non-spousal beneficiaries (e.g. children and grandchildren). When an IRA is left to a child, grandchild or other non-spousal "designated beneficiary" (as defined under the Treasury Regulations), such beneficiary may withdraw RMDs over his or her own life expectancy, beginning in the year following the account owner's death (known as an "Inherited IRA" or "Stretch IRA"). This allows for an extensive deferral of the taxation of these inherited benefits. Additionally, if an IRA is left to anyone other than a "designated beneficiary" (e.g. an estate), the IRA must be completely withdrawn within 5 years of the account owner's date of death.

While the SECURE Act leaves the Spousal Rollover intact, it now eliminates the Stretch IRA. Under the Act, when an IRA is inherited, the beneficiary must withdraw the entire IRA within 10 years of the account owner's death and now prohibits the election to withdraw the funds over the beneficiary's life expectancy. This means that the IRA will be fully taxed within 10 years and the tax-deferral is lost. However, the old 5-year rule for non-designated beneficiaries (e.g. an estate) remains unchanged.

Exceptions to the new 10-year rule are provided for certain beneficiaries, including a disabled person, a chronically ill person or a minor child. For example, the 10-year clock for a minor child begins to run when the child reaches the age of majority. Nevertheless, these tax changes are not retroactive and will not affect anyone who has already inherited an IRA prior to January 1, 2020.

No Age Restrictions on IRA Contributions

The Act now permits individuals to contribute to a traditional IRA in the year that they turn 70 ½ and beyond; provided, however, that they have earned income in a given tax year. Currently, the law does not permit contributions to traditional IRAs after age 70 ½.

401(k) Annuity Options

The Act now requires 401(k) plan administrators to provide an annual lifetime income disclosure statement to plan participants. This statement must include an illustration of the amount of money that a participant could receive each month if the 401(k) account balance were used to purchase an annuity. In addition, the law also makes it easier for 401(k) plan sponsors to offer annuities and other lifetime income options to participants, as well as makes it easier for employees to transfer retirement plan assets when they change jobs.

Small Business Planning

The Act now makes it easier for small businesses to collaboratively offer retirement plans to employees. Under the terms of the Act, the new law removes the requirement that small companies be similar and in the same industry in order to offer employees retirement plan options. Now, any combination of small businesses may join together to offer their employees retirement options.

Separately, starting in 2021, the Act guarantees 401(k) plan eligibility for employees who have worked at least 500 hours per year for at least three consecutive years. However, the part-time employee must be 21 years old by the end of the three-year period.

Tax and Estate Planning Opportunities

One method that individuals could use to ease future tax burdens would be to convert their traditional IRA funds into a Roth IRA. Although the individual would have to pay the taxes now, any future withdrawals by the taxpayer, or their beneficiaries, would be tax-free.

Life Insurance is an alternative to the stretch IRA. For those individuals who do not need access to any money in their retirement accounts, they should consider a permanent life insurance policy which is distributed to a life insurance trust. Any required distributions during the account owner's lifetime may be used to fund the life insurance premiums, which upon death, will be distributed tax-free to the beneficiary.

It is imperative that clients review their estate and financial plans. Estate plans were often designed, in part, to preserve the IRA "stretch." As a result of the SECURE Act, planning may need to be revisited with updated instruments to achieve the desired intent. Please contact our office to discuss the impact of the SECURE Act on your estate plan as soon as possible.

We are still in the process of reviewing the implications of the SECURE Act and will post updated commentary upon further analysis.