



COMMITTEE REPORT: RETIREMENT BENEFITS

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The SECURE Act—One Year Later

Identify clients who are affected by the changes, and determine how best to implement estate-planning strategies

The Setting Every Community Up for Retirement Enhancement (SECURE) Act¹ was signed into law on Dec. 20, 2019. Now, over a year later, we've had some time to identify the provisions of the SECURE Act that have significantly impacted distribution and estate planning for retirement benefits. The challenge for professionals is to identify clients who are affected by these changes and determine how best to implement effective planning strategies. To that end, we revisit some of these changes and explain how they impact retirement account owners and beneficiaries.

Significant Changes

Here are a few of the significant changes made by the SECURE Act:

End of stretch. One of the most beneficial estate-planning features available before the SECURE Act was for a designated beneficiary (an individual or a qualified trust) to take required minimum distributions (RMDs) from an inherited individual retirement account over their life expectancy or over the life expectancy of the oldest beneficiary of a trust. This was especially beneficial for designated beneficiaries who were very young. For example, a designated beneficiary who inherited an IRA at age 34 could stretch distributions over 48 years, allowing for continued tax-deferred growth on amounts that remain after the RMDs. Except for any basis, distributions from

an inherited traditional IRA would be taxable, but stretching these distributions over a long period could mitigate any income tax owed. Distributions from an inherited Roth IRA would be tax free.

The SECURE Act took away that benefit for certain designated beneficiaries who inherit IRAs and other retirement accounts after 2019 by limiting their distribution period to 10 years.

Under the SECURE Act's 10-year rule, a designated beneficiary must distribute the entire inherited IRA by Dec. 31 of the 10th year after the employee's or IRA owner's death. For example, if an IRA owner dies in 2021, the inherited IRA must generally be fully distributed by Dec. 31, 2031. Until then, no distributions are required, but the beneficiary may choose to take distributions if they so desire.

The 10-year rule also applies to successor beneficiaries when the IRA owner died before 2020, but the designated beneficiary dies after 2019. Before the SECURE Act, a successor beneficiary was able to continue taking distributions over whatever period remained when the designated beneficiary died. For example, a designated beneficiary who inherited an IRA at age 34 could take distributions over 48½ years. If they died 10 years later, the successor beneficiaries could continue to take distributions over the remaining 38½ years. However, under the SECURE Act, a successor beneficiary who inherits an IRA from a designated beneficiary who inherited the IRA before 2020 and dies after 2019 must take complete distributions from the inherited IRA within 10 years after the designated beneficiary's death. If an eligible designated beneficiary (EDB) inherits an IRA after 2019 and dies, the successor beneficiary would have to take the remaining benefits by the end of the 10th calendar year following the EDB's death.

Repeal of contribution age limit. Individuals

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previously weren't permitted to contribute to a traditional IRA in or after the year they reached age 70½. The SECURE Act repealed the age limit for contributing to a traditional IRA. While there are still income limitations on deducting contributions to a traditional IRA for an individual covered under an employer plan or an individual who's married to someone who is, anyone with wages or earnings or whose spouse has wages or earnings may now make contributions to a traditional IRA.

While there's no age limit for contributing to a Roth IRA, there's an income limit for Roth IRA contributions. For those whose incomes are too high to contribute directly to Roth IRAs, contributions can be made to traditional IRAs and then converted to Roth IRAs. This is commonly known as a "backdoor" Roth IRA contribution. However, IRA owners who have other assets in traditional IRAs should keep in mind that the basis and pre-tax amounts included in the conversion is prorated among all traditional IRAs (including simplified employee pension (SEP) IRAs and savings incentive match plans for employees IRAs) even if the nondeductible contribution is made to a separate traditional IRA. Rolling the pre-tax traditional IRA balance to an employer plan and leaving only the nondeductible contribution to be converted to the Roth IRA may be a workaround, but this strategy is only available to those who are participants in employer plans and only if the plan accepts such rollovers.

Qualified birth or adoption exception. The SECURE Act added a qualified birth or adoption distribution as a new exception to the 10% early distribution penalty that applies to distributions that occur before an account owner reaches age 59½.

The amount eligible for the exception is capped at \$5,000 per qualifying birth or adoption and must be made from an IRA or employer plan during the 1-year period beginning on the date a child of the account owner is born or on the date the legal adoption is finalized. For this purpose, adoptees must be under age 18 or physically or mentally incapable of self-support. Qualified birth or adoption distributions may be rolled over, and an amount that's properly rolled over is excluded from income.

New required beginning date. The age when RMDs must begin is increased to 72 for retire-

ment account owners who reach age 70½ after 2019. Participants in employer-sponsored retirement plans who aren't 5% owners may defer RMDs past age 72 until retirement. The option to defer the first RMD until April 1 of the next year is still available.

Extended deadline to establish qualified plans. Before the SECURE Act, the only employer-level retirement plan a business could establish after year-end was a SEP IRA. A SEP IRA may be established as late as the tax-filing due date of the business, including extensions. Under the SECURE Act, qualified plans such as Internal Revenue Code Section 401(k) plans, profit sharing and pension plans now benefit from the same extended deadline. This means that when business clients meet with their tax preparers to discuss options for reducing their taxable income and saving for retirement, the retirement savings options for their employees are now much broader.

Strategies to Consider

Many clients will be seeking advice regarding how to counter the end of the stretch option that was eliminated by the SECURE Act. Here are some strategies to suggest:

1. Take advantage of one of the exceptions to the 10-year rule. These include:

- **Governmental plans.** The 10-year rule doesn't take effect for governmental plans, such as the Federal Thrift Savings Plan, until 2022. As a result, beneficiaries of government employees who die before 2022 aren't subject to the SECURE Act's 10-year rule.
- **EDBs.** The SECURE Act created the new category of EDBs. EDBs may take distributions under the 10-year rule or over their life expectancies. An EDB is a beneficiary who's:
 - the spouse of the deceased account owner
 - a minor child of the deceased account owner
 - a disabled individual
 - a chronically ill individual
 - an individual who isn't more than 10 years younger than the account owner

A minor child must take complete distribution



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within 10 years after reaching majority.

Because EDBs get more benefits from IRAs than others, it will sometimes make sense to leave retirement benefits to or in trust for EDBs and leave other assets to or in trust for other individuals.

2. Limit beneficiary income bunching. A designated beneficiary who inherits a traditional IRA must include that amount in income within 10 years. Even if the income is spread out over 10 years, it could be subject to a higher income tax rate than if the amount were spread over the beneficiary's life expectancy. This is especially so for trusts, because trusts reach the top income tax bracket (37%) at \$13,050 of taxable income.

This income bunching creates a tension between making distributions to beneficiaries in lower brackets to save income taxes and accumulating income in a trust for asset protection. Even if the trustees make distributions or the IRA is payable to the beneficiaries outright, the limited distribution period under the 10-year rule may cause larger amounts to be included in income, resulting in higher tax rates.

Individuals with large traditional IRA balances may want to consider Roth conversions to avoid this income bunching for their beneficiaries. By converting amounts to Roth IRAs, the IRA owners would leave tax-free Roth IRAs to their beneficiaries, avoiding the potential higher income tax rates resulting from bunching the distributions from traditional IRAs over 10 years.

For example, an IRA owner could convert just enough to fill up their current tax bracket each year. Alternatively, an IRA owner could convert enough each year to bring them up to the top of a desired tax bracket. In that regard, the Tax Cuts and Jobs Act of 2017 widened the joint return brackets through the 32% bracket to double the width of the single brackets for 2018 through 2025, and the 24% bracket for joint returns goes up to \$329,850 of taxable income in 2021. This allows many IRA owners to convert substantial amounts within low and moderate tax brackets.

Distributions from a Roth IRA are tax free as long as the Roth IRA has been funded for at least five years. This 5-year period begins when the owner funded their first Roth IRA. With this tax-free option, a designated beneficiary could wait until the

end of the 10-year period to take a lump sum distribution, allowing the Roth IRA to grow tax free for 10 years following the IRA owner's death.

3. Use conduit and accumulation trusts. Extra care must now be taken when naming a trust as the beneficiary of retirement accounts.

One such trust is a conduit trust, in which the trustee must immediately distribute to its beneficiary all available income and principal, even if a beneficiary has creditors. If the beneficiary of a conduit trust is an EDB, the trustee may take distributions from the retirement account over the beneficiary's life expectancy. However, other than in that instance (that is, when a conduit trust has an EDB), a conduit trust generally makes little sense under the SECURE Act, because it forces all of the IRA distributions out of the trust within 10 years, throwing them into the beneficiary's estate and exposing the distributions to the beneficiary's creditors, spouse and Medicaid rules.

Accumulation trusts, on the other hand, may be a better option for IRA owners who previously left their IRAs to conduit trusts for individuals who aren't EDBs. Such IRA owners may wish to convert those conduit trusts to accumulation trusts so that the trustees may retain the IRA benefits in trust after receiving them from the IRA.

Note that accumulation trusts for disabled and chronically ill individuals qualify for the life expectancy stretch as long as no distributions may be made to anyone who isn't disabled or chronically ill during the disabled or chronically ill beneficiary's lifetime.

4. Use a charitable remainder unitrust. Another option is to use a charitable remainder unitrust (CRUT) to replicate the stretch. A CRUT provides annual or more frequent payments equal to 5% or more of the value of the trust each year, recalculated annually, to one or more individuals for life or for up to 20 years, with remainder to charity. The actuarial value of the charity's interest has to be at least 10% of the initial value of the trust.

Because a CRUT is tax exempt, it may receive the entire IRA at once without incurring any tax. Distributions to the beneficiary carry out the trust's current and accumulated income. The first distributions are ordinary income (including the amount



received from the IRA), followed by capital gains, tax-exempt income and return of principal. Within each tier, income taxed at higher rates passes through before income taxed at lower rates.

For example, if the payout rate is 5% and the trust earns 5% each year, the distributions for the first 20 years will be the IRA benefits. In addition, the IRA owner will receive an estate tax deduction for the actuarial value of the charity's remainder interest.

The benefit of the lifetime stretch will often offset or exceed the value of the remainder interest passing to charity. A CRUT generally works well for beneficiaries who are young (but at least age 28), are likely to need distributions, are unlikely to have taxable estates and have other money available for one-off needs.

Depending on the ages of the beneficiaries, it may be possible to have more than one individual beneficiary, though the payout rate will have to be reduced to satisfy the 10% requirement for the actuarial value of the remainder interest.

Further changes might be implemented, given the pending Securing a Strong Retirement Act.

If there's only one individual beneficiary, the unitrust payments will end at the beneficiary's death. If the beneficiary's family is dependent on the unitrust payments, the beneficiary may want to buy life insurance to protect their family against the loss of the unitrust payments on their death.²


When a Minor Becomes an Adult

While many of the SECURE Act provisions are clear, there are still some uncertainties. These include determining when a minor reaches the age of majority. The SECURE Act provides that a minor doesn't reach majority until the completion of a specified course of education, but not beyond age 26. However, we don't know what constitutes the completion of a "specified course of education." For example, a child could take a gap year between high school and college, work for a couple of years between college and business or medi-

cal school or join the military or the Peace Corps. The age 26 limitation should prevent abuse.

SECURE Act 2.0

Many advisors have already begun to implement strategies and make changes to their clients' retirement plan solutions to align with the changes made by the SECURE Act. But these changes appear to be only half of the SECURE Act game, as further changes might be implemented, given the pending Securing a Strong Retirement Act. (Note that the pending bill is popularly dubbed "SECURE Act 2.0.") Provisions of SECURE Act 2.0 include:

- Increasing the RMD starting age to 75. In addition to providing an additional three years for deferring RMDs, this would give IRA owners three additional years to convert amounts to Roth IRAs without having to first take RMDs.
- Exempting RMDs until age 75 for those whose account balances total \$100,000 or less.
- Increasing the limit for qualified charitable distributions from \$100,000 to \$130,000.
- Expanding the type of retirement accounts from which qualified charitable distributions can be made to include qualified plans. As of now, these distributions may be made only from IRAs and IRA-based plans.
- Expanding the exception to the 10% early distribution penalty for taxpayers under age 55 to include private firefighters (note that the early distribution exception for qualified public safety employees in governmental plans kicks in at age 50).
- Reducing the 50% excess accumulation penalty on RMDs that aren't taken by the applicable deadlines from 50% to as low as 10% in certain cases.
- Increasing the maximum saver's credit from \$1,000 to \$1,500 and adopting a single credit rate of 50% instead of the tiered rate. 

Endnotes

1. Setting Every Community Up for Retirement Enhancement Act of 2019, Pub. L. 116-94.
2. Bruce D. Steiner, "Charitable Remainder Trusts Replicate the Stretch for IRAs," *Trusts & Estates* (April 2020).