SANDBERG PHOENIX

WEALTH PLANNING BLOG

# SECURE Act: What You Need to Know

AUTHOR: JASON M. SALINARDI

On December 20, 2019, President Trump signed the Setting Every Community Up for Retirement Enhancement Act (SECURE Act), which became effective January 1, 2020.

The SECURE Act is the most significant legislation affecting retirement accounts in decades. The SECURE Act:

- Defers the required beginning date (RBD) for required minimum distributions (RMDs) from your individual retirement accounts from 70 1/2 to 72 years of age;
- Eliminates the age restriction for contributions to qualified retirement accounts;
- Requires most designated beneficiaries (with a few exceptions, such as spouses and minor children and disabled beneficiaries) to withdraw the entire balance of an inherited retirement account within ten years of the account owner's death.

This last change could significantly increase the tax bill for non-spouse beneficiaries. Previously, beneficiaries of inherited retirement accounts could take distributions over their life expectancy. Under the SECURE Act, the shorter ten-year time frame for taking distributions will likely result in income tax being accelerated and possibly causing the beneficiaries to be bumped into a higher income tax bracket, thus receiving less of the funds contained in the retirement account than originally anticipated.

Because of this monumental change in the way inherited retirement accounts are treated, it is crucial to ensure that clients plan accordingly. Keeping an eye on tax consequences and asset protection needs, there are several strategies that we can use to address this new paradigm.

*Roth Conversions*

As it relates to the ten-year rule, the purpose of Roth Conversions is to spread distributions over many years and lower brackets. There are several factors that clients need to carefully analyze the potential benefit of Roth Conversions:

- Post-death distributions from Roth IRAs are tax-free to beneficiaries

- Scheduled increase of income tax rates in 2026 (if not sooner)
- Impact of the 3.8% Medicare surtax
- Impact on taxation of Social Security and Medicare premiums
- Surviving spouse will be subject to compressed tax-brackets due to change in filing status

*Revocable Living Trust (RLT) or Standalone Retirement Trust (SRT)*

An RLT or SRT might be the best estate planning tool for these unique assets. We should, however, reconsider the use of “conduit” trust provisions because they require any required minimum distributions (RMDs) to be distributed directly to the beneficiary through the trust. Under the SECURE Act, the balance of the account would have to be distributed directly to the beneficiary by the end of year ten, which is an outcome our clients might want to avoid. Now, an “accumulation” trust provision may be more beneficial. This provision allows the trustee to receive the RMDs from the retirement account as often as required by law but allows the trustee to exercise discretion as to when and how much of the funds are distributed to or used for the benefit of the beneficiary. Although the trust will pay income tax on any of the distributions from a retirement account that are not distributed to the beneficiary, for many beneficiaries, it is equally if not more important to protect the money from the beneficiary’s creditors, divorces, or lawsuits.

*Charitable Remainder Trust (CRT)*

For charitably inclined clients, a charitable remainder trust may be the right solution to plan for the disposition of their retirement accounts. Such a trust would allow the client to name beneficiaries to receive an income stream from the retirement account for a period of time, with the remainder going to a charity named in the trust agreement.

A CRT can provide deferral of income tax consequences beyond the ten-year time frame under the SECURE Act, resulting in income tax bracket management for beneficiaries. Over time, if managed properly, the CRT could possibly convert ordinary income into capital gain income, resulting in further income tax savings.

It is important to note that this strategy is best for individuals who are already charitably inclined. This strategy may not result in the beneficiaries getting more than they would have utilizing other estate planning strategies, but if the client already has a charitable component in his/her estate plan, this may achieve the client’s goals in a more tax favorable way.

*Irrevocable Life Insurance Trust (ILIT)*

Due to the new ten-year withdrawal rule, there will be an acceleration of the beneficiaries' income tax on inherited retirement accounts, potentially moving them into a higher income tax bracket. The new rule may also result in the amount of cash available to beneficiaries being less than the client originally anticipated. In order to help offset this shortfall, your clients may want to consider using funds from their retirement accounts during their life to purchase additional life insurance and transfer ownership of the policy to an ILIT. The ILIT will help protect the insurance funds from the beneficiary's creditors and, generally, would be designed so that the proceeds from the life insurance policy are not includible in the client's estate.

*Multi-Generational Spray Trust*

Any number divided by a large number results in a smaller number. The same philosophy is true with distributions involving retirement accounts. While the distributions must be made within ten years, by distributing the retirement account to multiple beneficiaries at the same time over the ten-year period, the RMDs received by each beneficiary will be smaller, and the resulting tax liability per beneficiary will be reduced. This may require revisiting a client's estate planning to revise the planning to facilitate such "sprinkling" distributions.

For asset protection purposes, it is always advisable that the distributions be made to a trust for the benefit of a beneficiary instead of directly to the beneficiary.

We are here to help you and your clients navigate the new rules. It might be important to review a client's existing planning documents or explore new planning opportunities under the SECURE Act. Proper estate planning can provide our clients with peace of mind while they are living and ensure their retirement assets are passed on to their loved ones in the most efficient and protected manner.