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CLIENT ADVISORY – SECURE ACT

The Impact On Retirement Planning

JANUARY 1, 2020

Our Trusts and Estates attorneys have been closely monitoring the SECURE Act, which was signed into law by President Trump on December 20, 2019. SECURE stands for “Setting Every Community Up for Retirement Enhancement” and will affect most retirement savers. This law significantly changes the advice our office gives regarding the juxtaposition of retirement planning and estate planning. The SECURE Act is effective January 1, 2020.

Under the new law, the required minimum distribution age has increased, the contribution age is eliminated, and, importantly, account beneficiaries are no longer able to stretch distributions across their lifetimes. Previously, individuals with a 401(k) or IRA had to withdraw required minimum distributions (“RMD”) in the year they turned 70.5 years old. Under the SECURE Act, the age increases to 72, based on increased life expectancies. The SECURE Act also eliminates the maximum age for traditional IRA contributions, which was previously capped at 70.5 years old. Now, there is no limit on the age through which contributions can be made.

The most significant change is the elimination of the ability to stretch withdrawals over a beneficiary’s lifetime. Under the old law, a young beneficiary could stretch distributions over a considerable period of time, which effectively deferred income tax and allowed the IRA balance to grow income tax free. The SECURE Act now requires beneficiaries to withdraw all assets of an inherited retirement account within 10 years of the retirement account holder’s date of death. There are no RMDs within those 10 years, but the entire balance must be distributed after the 10th year. This new law limits the timeframe the designated beneficiary has to distribute the inherited account, which will increase the overall tax burden. This provision of the SECURE Act only applies to retirement accounts that are inherited after January 1, 2020. Current beneficiaries taking required minimum distributions from inherited accounts will not be affected.

For example, an individual with a $2 million retirement account has named their oldest child, aged 45, as the designated beneficiary. The child is in his/her prime earning years, and consequently in a high tax bracket. Under the 10 year payout rule of the SECURE Act, the child must withdraw all of the money by the time he/she reaches the age of 55. There is no RMD, so they could wait until the 10th year to withdraw the money. Assuming the $2 million is withdrawn in the 10th year, it would all be taxable as income in that year, and almost half of the $2 million would be lost to taxes.

Under the SECURE Act, certain beneficiaries are not subject to the 10 year payout rule, and therefore, can withdraw plan assets over their life expectancy—surviving spouses, chronically ill heirs, disabled heirs, and those named who are no more than 10 years younger than the plan owner. Additionally, minor children are not subject to the 10 year payout rule as long as they are minors. When the minor child reaches the age of majority, which is 18-21 depending on the state you reside, the 10 year payout rule will begin. In Massachusetts, the age of majority is 18.

For some clients, it was advisable to create a see-through trust and name the trust as the beneficiary of their retirement account. In these types of trusts, individuals were able to take advantage of the stretch payout while protecting and preserving the balance of a large retirement account for the future generation. Some see-through trusts only allow the beneficiary to receive the RMD every year and no more. Others allow RMDs to be accumulated within the trust for a beneficiary or class of beneficiaries before being ultimately distributed to a remainder beneficiary. See-through trusts were often used for minor beneficiaries or to protect the balance of a large retirement account from fiscal irresponsibility or creditors of the beneficiary.

The SECURE Act also brings new benefits. First, it allows for penalty-free withdrawals of up to $5,000 from IRAs and certain other plans to pay for expenses related to the birth or adoption of a child.[1] Under the old law, there was a 10 percent penalty associated with this type of withdrawal. Second, it is anticipated that more employers, especially small business employers, will be able to offer retirement plans to employees because of new tax incentives and the ability to form common retirement plans with other small businesses, known as open multiple employer plans. Additionally, more part-time employees will become eligible for employer-sponsored retirement plans. Lastly, this new legislation expands the use of 529 education savings accounts to registered apprenticeships, up to $10,000 of qualified student loan repayments, and private elementary, secondary, or religious schools. The student loan provision allows individuals to repay student loans for a 529 beneficiary up to a $10,000 limit in addition to up to $10,000 for each of the 529 plan beneficiary's siblings.

Most estate plans should be evaluated in light of the SECURE Act, especially those who have named their revocable trusts as beneficiaries of retirement accounts and those who have high balance IRA accounts. If you would like to schedule a meeting to evaluate the impact of the new law on your personal estate plan or would simply like to talk over the current structure of your estate plan, please be in touch.

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[1] Although there is no longer the 10% penalty fee, the withdrawal under the new law is still subject to taxes.