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The SECURE Act: What Estate Planners Need to Know

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The SECURE Act: What Estate Planners Need to Know

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1. SECURE Act Overview; Background Regarding Distribution Requirements from Qualified Plans and IRAs

Some of the following overview of planning implications of the SECURE Act is largely based on presentations and resources from Natalie Choate (Boston, Massachusetts) at the 2020 Heckerling Institute on Estate Planning and by a presentation by Deborah Tedford and Steven Trytten at the ACTEC 2020 Summer Meeting.

a. Introductory Background.

The **SECURE Act** (H.R. 1994, Setting Every Community Up for Retirement Enhancement Act of 2019) was a proposal to make various changes regarding retirement benefits. The bipartisan proposal was unanimously approved by the House Ways and Means Committee and passed the House by a vote of 417-3. Similar proposals had been introduced in the Senate.

The SECURE Act was included as Division O of the late 2019 "spending bill," H.R. 1865, the Further Consolidated Appropriations Act, 2010. That Act passed the House (297-120), the Senate (71-23), and was signed by the President on December 20, 2019.

The miscellaneous retirement plan changes in the SECURE Act include liberalized rules for multiple employers, a new small employer automatic enrollment credit, expanded participation in employer 401(k) plans to include long-term part-time workers, certain expanded uses of Section 529 plans (see the following paragraph), tax-free $5,000 permitted withdrawal within one year after the birth or adoption of a child by the participant, and required annual disclosures of estimated projected lifetime income under annuity elections.

The changes for 529 plans include treating the cost of apprenticeship programs as qualified education expenses and allowing distributions of up to $10,000 for repaying qualified education loans of the beneficiary or the beneficiary's sibling. Note that distributions from a 529 plan that is not owned by the student or a parent of the student are reported as untaxed income on the "Free Application for Federal Student Aid (FAFSA) Form that many colleges use for financial aid applications. College financial aid may be reduced by 50% of the untaxed income reported on the FAFSA Form, but repayments of student loans do not have to be reported. Accordingly, if a 529 Plan has been established by a grandparent, to avoid reporting a $10,000 plan distribution on the FAFSA Form, which may reduce financial aid by 50%, the student could obtain a student loan and use distributions from the plan to repay $10,000 of the loan.

The Act also repeals the provision in the 2017 Tax Act regarding the "Kiddie Tax" applying the income tax rates for trusts to the unearned income of children and allows taxpayers to elect to treat the repeal as effective for 2018 and 2019. (This has been called the "Gold Star" family provision because the 2017 Kiddie Tax changes had adversely impacted children who received government payments because they are survivors of deceased military personnel and first responders.)

MORE important for estate planners, the SECURE Act:

- Changes the age that determines the required beginning date (RBD) for minimum distributions (April 1 of the following calendar year) from 70½ to 72, effective for individuals who reach age 70½ after December 31, 2019 (the effect is that no one will have his or her RBD in 2021); (A similar Senate proposal would have extended the required beginning date age to 75 and removed it entirely for plans [other than defined benefit plans] worth up to $100,000, and those provisions are included in the Neal-Brady "Securing a Strong Retirement Act of 2020" bipartisan bill introduced on October 27, 2020); (Observe that the CARES Act waives required minimum distributions for all retirement accounts except defined benefit accounts in 2020 (this includes IRAs, even inherited IRAs)); and

- Eliminates the prohibition on contributions to an IRA after age 70½ (but the $100,000 limit on qualified charitable distributions from an IRA would be correspondingly reduced [observe that changing the age for required minimum distributions from 70½ to 72 will not change the age at which qualified charitable distributions from IRAs will be permitted]). See Notice 2020-68, 2020-38 IRB. See Item 12.c below for a discussion about IRA charitable rollover planning.

MOST important for estate planners, the SECURE Act **substantially limits "stretch" planning** for distributions from defined contribution plans (and IRAs) following the death of the plan owner (referred to as the "participant"), therefore, the changes apply to 401(k) plans as well. Under prior law, following the participant's death, plan benefits (including IRA benefits) could be paid over the life expectancy of a "designated beneficiary" (DB), to stretch the receipt (and, therefore, the income taxation) of retirement benefits, but the SECURE Act mandates that distributions to a designated beneficiary be made within 10 years following the death of the participant, with exceptions for five categories of "eligible designated beneficiaries" (EDBs). Distributions from the IRA are typically taxed as ordinary income, so the ability to stretch the receipt of those benefits as long as possible defers the time that the income tax must be paid. (Throughout this discussion of the SECURE Act, references to a "plan" or "plan benefits" will include an IRA.)

b. **Post-Death Minimum Distribution Requirements under Prior Law.** A grasp of the prior law minimum distribution requirements following the death of the participant is essential to understand the impact of the changes made by the SECURE Act. Most of this prior law is retained under the SECURE Act (except for the 10-year rule for designated beneficiaries, with special rules for the five categories of eligible designated beneficiaries). The rules are based on regulations proposed in 1987 and 2001 and finalized in 2002, almost 20 years ago. A simplified summary of the prior law follows [provisions impacted by the SECURE Act are briefly noted in italicized comments in brackets].

The treatment varies based on whether or not the beneficiary is a DB, meaning any individual but not an entity such as the participant's estate, a charity, or a trust that is not a "see-through" trust (described in Item 1.c below).

(1) **Beneficiary Not a Designated Beneficiary.** If the beneficiary is not a DB (Non-DB), benefits must be paid within 5 years if the participant died before his or her required beginning date (RBD) or over the participant's remaining life expectancy (this is sometimes referred to as the "ghost life expectancy") if the participant died on or after the RBD. [*This does not change under the SECURE Act.*] The RBD is April 1 of the year after the participant reached age 70½ if the participant reached that age by December 31, 2019 [*changed to age 72 in the SECURE Act*].

(2) **Beneficiary is a Designated Beneficiary Other Than a Surviving Spouse.** If the beneficiary is a DB and is not the surviving spouse, the benefits are paid over the DB's life expectancy (if a see-though trust is the beneficiary, over the oldest beneficiary's life expectancy). (If the participant's remaining life expectancy is longer, that period may be used. Reg. §1.401(a)(9)-5, A-5(a)(1).) [*The SECURE Act changes this to a maximum 10-year payout instead of the DB's life expectancy; whether the Act changes from allowing the participant's life expectancy if that is longer is unclear if the beneficiary is a DB.*]

(3) **Beneficiary is the Surviving Spouse.** If the beneficiary is the participant's surviving spouse, the DB rule described above can apply (that would be applicable, for example, if the beneficiary is a standard QTIP trust that does not mandate that all distributions must pass to the spouse), but even more favorable alternatives may also be elected in some circumstances. If the spouse is the sole beneficiary, the Single Life Table is used, but the life expectancy is recalculated annually.

Better still (in most circumstances), if the spouse chooses to treat the decedent's IRA as his or her own IRA (spousal election) or elects to rollover the decedent's IRA into the spouse's IRA (a spousal rollover), several significant advantages result. (1) Distributions do not need to begin until the spouse reaches his or her RBD. (2) Distributions are made at a slower pace because the Uniform Life Table may be used (which is based on the joint life expectancy of the individual and someone who is 10

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