

# SECURE Act Significantly Changes Individual Retirement Account Payouts

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**PRACTICES** Tax, Private Clients and Estate Planning, Family Wealth and Estate Planning, Trust and Estate Administration, Family Office, Tax-Exempt Organizations and Private Foundations

For over 30 years, many of our clients with large retirement accounts have been able to maintain these benefits tax-deferred not just for their lifetimes, but also for the lifetimes of their children. This allowed the benefits to be taken out gradually (and hopefully in a lower tax bracket) and the account remained exempt from federal income tax.

With the passage of the “Setting Every Community Up for Retirement Enhancement” Act (the “SECURE Act”), these benefits are no longer available. As of January 1, 2020, when an account owner passes away, except as discussed below, the deceased account owner’s retirement account and/or IRA must be paid out within 5 or 10 years. The SECURE Act replaces the life expectancy payout with a 10-year payout for all but 5 specified categories of designated beneficiaries (known as “eligible designated beneficiaries”): (i) surviving spouses, (ii) minor children of the participant (provided, however, after such child has reached majority, the balance in the account must be distributed within 10 years), (iii) disabled beneficiaries, (iv) chronically ill beneficiaries, and (v) beneficiaries less than 10 years younger than the participant.

**Payments to a Trust.** Frequently, our clients have designated trusts for the benefit of their children or other descendants to receive these retirement benefits. Prior to the passage of the SECURE Act, the trust would function in one of two ways: (i) each distribution from the retirement account would flow through the trust directly to the beneficiary (“conduit trust”) or (ii) distributions would remain in the trust, subject to the trustee’s discretion to make distributions for the benefit of the beneficiary (“accumulation trust”). While these two trust techniques are still viable options, the benefits of the conduit trust are significantly reduced.

**Conduit Trust.** Prior to the SECURE Act, when the beneficiary of a conduit trust was receiving a distribution each year, it was only a small percentage of the total retirement account and generally lasted over the life expectancy of the beneficiary. For this reason, most of our clients have utilized this conduit trust option. Now, except for the five special exceptions noted above, the entirety of the retirement account will be distributed to the beneficiary by the 10th anniversary of the account owner’s death. Depending on the beneficiary’s circumstances, this outright distribution could conflict with the account owner’s intent.

**Accumulation Trust.** Because of these changes, an accumulation trust may be a better option for many account owners. Except in certain instances, there are two options to consider with an accumulation trust: (i) 10-year payout of the retirement account into the accumulation trust or (ii) 5-year payout of the retirement account into the accumulation trust. In order to qualify for the 10-year payout, (i) the beneficiaries must be identifiable, i.e., specifically named in the document or a member of a class of beneficiaries that could be identifiable (for example, children or grandchildren), and (ii) all of the trust beneficiaries must be individuals, i.e., a charity could not be a beneficiary, even a remote contingent beneficiary. Failure to satisfy these two provisions will cause the trust to have “no designated beneficiary,”

and the retirement account must generally be paid to the trust by the 5th anniversary of the account owner's death.

Regardless of the length of the payout, an accumulation trust allows the assets of the retirement account, after payment of income taxes, to remain in trust for the beneficiary. This preserves the benefits of a trust, such as creditor protection, protection from divorce, disability or substance abuse. Especially when there is significant wealth in a retirement account, maintaining these protections can have several advantages over automatic outright distribution to a beneficiary.

## **Other Significant Provisions in the SECURE Act.**

- Increasing the age for starting required minimum distributions from 70½ to 72 for people born after June 30, 1949.
- Removing the age cap for contributions to a traditional IRA.
- The ability to make plan distributions (up to \$5,000) to pay for expenses related to the birth or adoption of a child without penalty.
- 529 plans can now (i) be used to pay for fees, books, supplies, and equipment required for the designated beneficiary's participation in an apprenticeship program and (ii) tax-free distributions (up to \$10,000) are allowed to pay the principal or interest on a qualified education loan of the designated beneficiary, or a sibling of the designated beneficiary.
- The Kiddie Tax has been reinstated (unearned income of a minor is again subject to tax at the parent's marginal rate) by the repeal of a special provision in the 2017 Act that made unearned income of a minor subject to tax rates of trusts and estates.

**Review Your Beneficiary Designations.** In light of these changes, you should contact your advisors in order to (i) review your current beneficiary designations and (ii) discuss how you might structure and best utilize your retirement assets in association with your estate planning.

For more detailed information on the SECURE Act, please click [here](#).