Finding Security After the SECURE Act
(Top 12 Things You Need To Know About the SECURE Act)

At the end of 2019, the "*Setting Every Community Up for Retirement Enhancement Act*" (the "SECURE Act" or "New Law") became law.[1] If you have retirement accounts,[2] the New Law **may** affect you and your family. The purpose of this Client Alert is to advise you of the most important changes for the distribution of your retirement accounts.

Lester Law and George Karibjanian have co-authored a two-part article titled, "FINDING SECURITY UNDER THE SECURE ACT: A COMPARATIVE ANALYSIS OF THE RULES PRE AND POST SECURE ACT", which is published in the Probate Practice Reporter, Volume 32, Number 2 (Feb. 2020) and Volume 32, Number 3 (Mar. 2020). These articles analyze and compare the SECURE Act with prior law. The purpose of this Client Alert is to provide a very cursory overview of the SECURE Act, as it applies to estate planning for lifetime and post-death distributions of your retirement accounts..

1. WHAT ARE THE UNDERLYING PURPOSES FOR THE SECURE ACT?

The answer is fairly straightforward: (1) to shorten the period of time that retirement accounts (which are tax deferred, or exempt with respect to Roth IRAs) may stay tax deferred (or tax exempt with respect to Roth IRAs; and (2) to raise tax revenues.

This concept of allowing the IRA to be distributed over a long period of time (generally determined by a beneficiary's lifetime), is often referred to as "stretching" and an IRA that was to be distributed over that lengthy period of time was often referred to as a "stretch IRA."

Congress passed the SECURE Act, primarily to curtail stretching. And, by curtailing stretching, it forces the retirement account to be distributed sooner, causing quicker income recognition, which further translates to raising revenues for the government sooner (i.e., the second purpose of the New Law).

2. WHEN DID THE SECURE ACT TAKE EFFECT?

January 1, 2020.

The SECURE Act takes effect as of January 1, 2020. For decedent's dying before that date, the rules that applied before then (the "Old Law") applied; for decedent's dying on or after that date, the SECURE act rules apply.

[1] The SECURE Act was part of the appropriation's bill titled *Further Consolidated Appropriations Act, 2020* (the 2019 Act), P.L. 116-94, which was signed into law on December 20, 2019.

[2] When we refer to retirement accounts, we generally mean Individual Retirement Accounts (IRAs), Section 401k accounts, Section 403b accounts and Section 457 accounts.

3. WILL THE SECURE ACT AFFECT ME?

Yes, but the New Law will affect different individuals differently, and there is no "one size fits all" solution or recommendation.

4. WHAT ARE THE IMPORTANT CHANGES AFFECTING **LIFETIME** DISTRIBUTIONS?

There are three (3) changes that affect lifetime distribution under the New Law.

First, the Old Law provided that you were generally required to begin taking required minimum distributions ("**RMDs**") from your retirement accounts in the year in which you turned the **age of 70 ½**. Now, under the SECURE Act, that age has been deferred until you reach **72 years of age**.

Second, under the Old Law, generally, you were not permitted to make contributions (i.e., add) to your retirement plans after age 70 1/2.[3] Under the SECURE Act, you can make contributions to your retirement plans until you die.

Third, under the New Law, if you make a so-called Qualified Charitable Distribution ("QCD"),[4] such QCDs will be reduced dollar-for-dollar for the amount of contributions that you made to your IRA after age 70 ½. This provision is made permanent in the law.

5. WHAT ARE THE IMPORTANT CHANGES AFFECTING **POST-DEATH** DISTRIBUTIONS?

Under the Old Law, in most circumstances, retirement accounts left to individuals and certain trusts that were, more or less, treated like individuals ("Qualified Trusts") could be distributed over the individual's (or primary beneficiary of the Qualified Trust's) life expectancy (the "**Life Expectancy Rule**"). The SECURE Act changes the Life Expectancy Rule, for most individuals (there are exceptions that we explain below) to a new "**10-Year Rule**." In most cases, this will cause the retirement accounts to be distributed sooner.

6. WHAT IS THE **10-YEAR RULE**?

The 10-Year Rule provides that when an Owner dies, and the Owner leaves his or her retirement account to an individual (or a Qualified Trust), then the retirement account must be distributed by December 31 of the 10th year following the year of the Owner's death.

Note, the 10-Year Rule is different from the Life Expectancy Rule. The 10-Year Rule only requires that all of the retirement account is distributed by the end of the 10-Year period; there is no requirement for annual distributions (i.e., everything can be withdrawn at the end). By comparison, the Life-Expectancy Rule (which is still in effect for certain individuals and certain Qualified Trusts, discussed below), requires that annual distributions be made (i.e., over the beneficiary's life expectancy).

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[3] This was an IRA rule (i.e., no contributions beyond attaining the age of 70 ½). If you are an employee of a company sponsored plan (e.g., a 401k plan), and if you are less than a 5% owner of the company, you could contribute until you retire.

[4] Since 2006, after attaining age 70½, an IRA Owner has the ability to distribute IRA funds directly to qualified charities up to an amount of $100,000, the effect of which was to treat those direct distributions as RMDs made by the Owner. Generally, making QCDs is viewed as being income-tax beneficial, because the QCD is treated as an RMD and it has no negative impact on the Owner's income tax situation.

7. ARE THERE ANY **EXCEPTIONS** TO THE **10-YEAR RULE**?

Certain persons known as "Eligible Designated Beneficiaries" (or "EDBs"), are able to use the old Life-Expectancy Rule. However, the Life Expectancy Rule is slightly changed depending on the type of Eligible Designated Beneficiary.

8. WHO ARE **ELIGIBLE DESIGNATED BENEFICIARIES** (OR "**EDBS**")?

There are five (5) groups of persons who are treated as EDBs:

1. Surviving spouse ("**Spouse**");
2. Minor child;
3. Disabled person;
4. Chronically ill person;
5. Person who is not more than 10 years younger than the Owner ("**Not 10-Year Younger Person**").

To the extent that the Owner leaves his or her retirement account to an EDB, the Life Expectancy Rule applies; however, it applies differently depending upon the type of EDB.

- <u>Spouse</u> - For EDBs who are Spouses, there are a number of rules that apply. First, Spouses who are outright beneficiaries are still able to roll-over or elect to treat the Owner's retirement account as the Spouse's account.[5] Second, if the Spouse does not roll-over or treat the IRA as the Spouse's retirement account, the Spouse could withdraw the IRA over the Spouse's life expectancy.
- <u>Minor Child</u> - For EDBs who are minor children of the Owner, (and note this only applies to minor children – it does not apply to other minors (e.g., grandchildren, family friends, etc.)), the retirement account can be distributed based upon the minor child's life-expectancy, until the minor child reaches the age of majority.[6] When the minor child attains the age of majority, the 10-Year Rule will apply from that year forward.

  By example, if the child is 12 when the Owner dies and turns the age of majority at age 21, from ages 13 (distribution rules apply following the year of death of the Owner) through 21, the retirement account is distributed based on the minor's life expectancy. Then at age 21, the 10-Year Rule would apply, so that the retirement account, at that point in time, would have to be distributed by December 31 in the year that the minor child attains age 31 (i.e., 10 years after

[5] The Old Law preserved the rules that allow surviving spouses to treat the inherited IRA as his or her own. The reason for this is that Congress wanted to preserve as much of the Old Law as possible and because surviving spouses were treated specially under both the Old and the New Law, Congress opted to simply leave that old rule in place.

[6] The SECURE Act provides its own definition of the term "majority", which does not occur when the individual turns age 18 (under most states laws) and as old as 21 in other states, but if the minor is a student (in college), depending upon the facts and circumstances, the minor may retain his or her minority until age 26. In those cases, the IRA can be held until the child attains the age of 36 (i.e., at age 26 the 10-Year Rule would apply).

the minor child attains the age of majority), but from age 21 through 31, annual distributions are not required.

- Disabled Persons – For individuals who are disabled at the time of the death of the Owner, the retirement account can be distributed to the disabled person over his or her life expectancy. If the disability disappears, then the 10-Year Rule will apply from that year forward.
- Chronically Ill Persons - For individuals who are chronically ill at the time of the death of the Owner, the retirement account can be distributed to the chronically ill person over his or her life expectancy. If the chronic illness disappears, then the 10-Year Rule will apply from that year forward.
- Not-10-Year-Younger Persons – For an individual who inherits a retirement account from an Owner, and who is not more than 10 years younger than the Owner (which includes those older than the Owner), the Life Expectancy Rule applies for that individual.

9. What if My Plan Included Leaving my Retirement Account in a Trust for my Beneficiaries? Does it still make sense to use the Trust under the SECURE Act?

Trusts are used not only for tax reasons, but for other purposes, such as asset protection, management and preservation of assets and wealth accumulation. It may be that a trust was used, not solely to attain the income tax benefits of the "stretch"; thus, it is entirely possible that the existing plan is perfectly fine, with the only possible difference is that the income that is distributed is taxed sooner than originally anticipated under the Old Law. On the other hand, there may have been a specific reason why one used a trust and the type of trust that was selected would be less effective or ineffective under the New Law. In such a case, a change should be made.

Each individual's circumstance is different; therefore, you should review your plan with your advisor, to see if it is still viable under the New Law.

10. What if I want to leave my Retirement Account to Charity?

The SECURE Act does not affect gifts left to charity. Retirement accounts left to charity upon the owner's death still qualify for the unlimited charitable estate tax deduction and avoid income taxes!

11. Does the SECURE Act affect my Roth IRA?

For lifetime distributions, the SECURE Act did not affect assets held in a Roth IRA. The reason for this is that the Roth IRA does not require Owners to make distributions during their life, therefore, changing the required distribution date from 70 ½ to 72 makes no difference.

For post-death distributions, however, Roth IRAs, like Traditional IRAs, were affected by the SECURE Act because the rules for post-death distributions from Roth IRAs are identical to the post-death distributions from Traditional IRAs. Therefore, to the extent that your Roth IRA is left to an individual (or trust) that is not an Eligible Designated Beneficiary, then the shorter 10-Year Rule will likely apply (i.e., the Roth IRA would have to be distributed by December 31 of the 10th year following your year of death).

As a side note, under the Old Law in certain circumstances, it may have made sense to convert from a Traditional IRA to a Roth IRA. Now, under the New Law, it may continue to make sense to convert, but the analysis is different. If you were considering converting before (i.e., under the Old Law), we recommend that you reconsider your decision, and re-analyze whether it makes sense under the SECURE Act.

12. What Happens if I Inherited an IRA Before 2020 and I'm taking Lifetime Distributions, Does the new 10-Year Rule Apply?

Yes, but not during your lifetime!

If an Owner died before December 31, 2019 (i.e., before the SECURE Act became effective), leaving his or her retirement account to an individual or a Qualified Trust (the "**Inheritor**"), the distribution rules under the Old Law would apply during the Inheritor's lifetime (i.e., the Inheritor could withdraw his or her required minimum distributions over his or her life expectancy). The SECURE Act does not change this result.

What has changed are the rules after the Inheritor dies! Under the Old Law (i.e., had the Inheritor died before December 31, 2019), the retirement account would have been distributed over the Inheritor's remaining life expectancy. However, under the SECURE Act, when the Inheritor dies, regardless of the Inheritor age at death, the 10-Year Rule would then apply (i.e., the balance of the undistributed retirement account will have to be distributed to the Inheritor's named beneficiary before December 31 of the 10th year following the Inheritor's year of death).

If you have any questions, please call one of our lawyers.

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