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MEMORANDUM

To: Clients and Friends

From: Schell Bray PLLC

Subject: SECURE Act

Date: January 2020

In December of 2019, the "Setting Every Community Up for Retirement Enhancement Act of 2019" (the "SECURE Act") was signed into law, with an effective date of January 1, 2020. This law made significant changes to the rules governing qualified retirement plans of all types, some of which impact estate plans. ***Throughout this memorandum, the term "IRA" is used for ease of understanding, but the same principles apply to all qualified retirement plans, including 401(k) and 403(b) plans***.

Significant SECURE Act Provisions Affecting Estate Planning

- Effective January 1, 2020, the prohibition on making contributions to a traditional IRA after age 70 ½ has been eliminated.

- The age at which a participant must start taking Required Minimum Distributions ("RMDs") from an IRA is increased from 70 ½ to 72, technically April 1 in the calendar year after the calendar year in which the individual reaches age 72. This change can be used by individuals who reach age 70 ½ in 2020 and thereafter.

- The SECURE Act allows a tax-free distribution of up to $10,000 from a 529 Plan to pay principal or interest on a qualified education loan of a designated beneficiary and his or her siblings.

- ***Unlike the three helpful changes mentioned above, the most impactful change made by the SECURE Act is the requirement that, with a few exceptions, beneficiaries of IRAs will no longer be able to take the benefits over the beneficiary's life expectancy and are now required to take the entire amount of the account within 10 years after the participant's death. In some situations, the entire IRA must be distributed within 5 years after the participant's death***.

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- The requirement to take the account balance within 10 years applies to both traditional IRAs and Roth IRAs.

- There are five exceptions to the 10-year requirement, and those are where the named beneficiary is: (1) the surviving spouse, (2) a minor child of the participant (extending for a period of time for adult children who are still in school), (3) a disabled beneficiary, (4) a chronically ill person, and (5) an individual who is not more than 10 years younger than the participant.

How These Changes Effect Estate Plans

- The "stretch IRA" has been a popular estate and tax planning tool for many years, allowing a child or grandchild of the IRA owner to take the benefits over his or her life expectancy, deferring the payment of income tax on the account assets and allowing the assets to remain in the account longer and build up on a tax-free basis.

- The change to a total required distribution within 10 years will mean that the distributions will be larger, the income taxes paid will be larger, and the after tax benefit of the account will be smaller.

- Even though the distributions from Roth IRAs will not be subject to income tax, the requirement to take the distributions within 10 years means that the beneficiary will not be able to benefit from tax-free investing inside the account for a longer period of time.

- Many clients choose to have their IRA benefits paid to a trust for their children or grandchildren. If the trust meets certain requirements, the trust is treated as a "see-through trust" and, under former law, the trustee could elect to receive the IRA assets over the life expectancy of the child or grandchild who was the beneficiary of the trust. ***Generally,*** u***nder the new law, a beneficiary's life expectancy will not be able to be used to calculate the distributions from an IRA.***

- There are generally two types of trusts that qualify for "see-through trust" status.

- The "conduit trust" has been the most popular "see-through trust". A conduit trust requires that all distributions from the IRA received by the trust be distributed to the beneficiary in the same year, resulting in the beneficiary paying income tax on the distributions in that same year. Many clients were willing to accept this tax treatment since the beneficiary's life expectancy was used to determine the size of the distributions, and the distributions were therefore not too large.

- The "accumulation trust" is another type of trust that can qualify as a "see-through trust", but this type of trust does not require that all distributions from an IRA be automatically distributed to the trust beneficiary. The distributions from an IRA can be accumulated in the trust and taxed to the trust in the year received, but the trade-off is that the income tax rates for trusts are punitive, with the highest federal tax rate (37%) beginning with taxable income of $12,951. There are also significant restrictions with regard to distribution after the death of the primary beneficiary of the trust.

- By forcing IRA distributions out at a much quicker rate (within 10 years), where a conduit trust is a part of an estate plan, the SECURE Act will force larger distributions out to beneficiaries earlier, which may not match the parent's or grandparent's intent for a younger or irresponsible beneficiary. In addition, because the required distributions will be larger, the taxes paid will be greater and the after-tax value of the IRA to the beneficiary will be smaller.

- Even though an accumulation trust may be used to avoid the same level of forced distributions to beneficiaries, the income tax cost of accumulating the distributions in the trust will be the payment of income tax by the trust at a punitive rate.

Options for Responding to SECURE Act Changes

The SECURE Act is very new and we are still studying its terms and options for addressing its changes, but some of the options for dealing with the 10-year payout requirement are as follows:

- Change beneficiaries to fit one of the five exceptions to the 10-year requirement.
- Leave the account to a greater number of beneficiaries.
- Consider leaving more of the account to charity.
- Consider a Roth conversion.
- If your plan includes leaving benefits to a conduit trust or an accumulation trust, determine if the type of trust still fits your situation.
- Leave the benefit to a charitable remainder trust.
- Purchase life insurance to replace the diminished benefit.
- After a thorough review, determine that you and your family will just have to live with the consequences of this new law.

Important Takeaways for Everyone Having an IRA

- You must be aware that a traditional IRA has significant "tax baggage". It is not as valuable to your heirs as stocks, bonds, cash or real estate that you may own outside of a retirement account. It is the first asset that you should consider for making charitable gifts.

- Even though the SECURE Act made a significant change in the period over which assets must be received from an IRA, your current beneficiary designations and your estate plans for these assets are generally still valid, even though the tax cost may be higher.

- If your spouse is your primary beneficiary of this asset, the SECURE Act has no effect on your spouse's ability to choose to receive the benefit over his or her life expectancy.

- If a spouse is not your primary beneficiary or if you have named children or grandchildren as secondary beneficiaries when both you and your spouse are deceased, the SECURE Act may affect your planning.

- If your estate plan anticipates that a retirement benefit will be payable to a trust, the SECURE Act may mean that the tax effects will be drastically different than what you had anticipated.

- There is no "fix" for this problem that applies to all clients. The response to these changes will depend on each client's individual situation.

- One thing has not changed. This has been and continues to be a cardinal rule in this area: ***Never name your estate as the beneficiary of an IRA or other retirement asset***.

In light of the information above, it is important that everyone with a retirement asset review his or her estate plan as it relates to the beneficiaries of that retirement asset. This is especially true if your plan utilizes a "see-through trust" to hold retirement assets.

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