



VIRGINIA ESTATE & TRUST LAW, PLC

ESTATE PLANNING UPDATE: THE SECURE ACT

The Setting Every Community Up for Retirement Enhancement (“SECURE”) Act of 2019, which became effective on January 1, 2020, is a new federal law that will dramatically affect estate planning for individuals with retirement accounts.

The SECURE Act makes several modifications to the existing rules governing tax-advantaged retirement plan assets, including traditional IRAs, Roth IRAs and 401(k)s (collectively, “IRAs”). The most significant SECURE Act provision is the elimination of the “stretch” option for most inherited IRAs. For persons dying in 2020 and beyond, the new collapsed inherited IRA payout structure under the SECURE Act will have substantial implications for beneficiaries, who will need to plan for the income tax consequences and may also need to revise their own estate plans.

Any IRA owner with a large IRA, an IRA payable to a trust, or a special family situation should prioritize review of all beneficiary designations and estate planning documents to ensure that their plan will produce the desired result.

Limitations on the use of the “stretch IRA”

The so-called “stretch IRA” method under prior law allowed IRA beneficiaries to spread out the distributions of their inherited IRA over their lifetime, allowing the bulk of the inherited IRA to continue to grow tax-free and subjecting only the amounts distributed from the account to income tax. When IRAs were passed to properly drafted trusts at an owner’s death, the trust beneficiaries could reap the benefits of stretch IRA tax-deferral, creditor protection, and professional management.

The SECURE Act eliminates the availability of the stretch IRA mechanism for nearly all non-spouse IRA beneficiaries. Now, only the following categories of beneficiaries may continue to use the stretch IRA in substantially the same form as before:

- Surviving spouses
- Minor children (but not grandchildren!)
- Disabled or chronically ill beneficiaries
- Any beneficiary who is less than 10 years younger than the account owner
- Trusts for the beneficiaries in categories listed above, if the trust contains certain provisions necessary to obtain stretch IRA treatment
- Inherited IRAs where the account owner died in 2019 or earlier. These inherited IRAs are grandfathered under the old rules and are eligible to continue stretch IRA treatment during the lifetime of the first beneficiary. After the beneficiary’s death, the SECURE Act revised provisions will apply.

For everyone else, the SECURE Act introduces a new 10-year payout rule. Most beneficiaries of an inherited IRA will be required to withdraw all IRA assets by the end of the tenth year following the plan owner's death. Income taxes are due upon withdrawal of assets from non-Roth inherited IRAs. There are no required annual withdrawals; therefore the beneficiary may wait until the end of the tenth year and face a large one-time income tax bill, or the beneficiary may choose to spread the distributions and income tax liability over the entire 10-year period. Either way, the new 10-year rule will significantly accelerate distributions from inherited IRAs and subject the assets to tax liability on a compressed timetable.

Planning Opportunities

Several planning mechanisms can be deployed to mitigate the tax impact of the elimination of the stretch IRA.

- **Charitable Remainder Trust** – For the charitably-inclined family, making all or part of the IRA payable to a charitable remainder trust is a tax-efficient way to pass IRA assets. Under this model, descendants can receive an income stream for life (nearly replicating the stretch IRA), and the remainder passes to charity at the death of the beneficiary family member. For estates subject to estate tax, this technique may save estate taxes as well.
- **Sprinkling Trusts** – When leaving an IRA in trust for descendants, give the trustee permission to distribute income among a broad class of beneficiaries (including grandchildren or others who may not be high earners). Although the 10-year payout rule will still apply, the trustee may be able to mitigate the income tax bite by spreading the income tax liability among individuals in lower tax brackets.
- **Roth Conversion** – Converting a traditional IRA to a Roth IRA during life will eliminate income tax liability concerns for beneficiaries. This can be especially useful if it is desirable to leave the IRA in trust for descendants for management or creditor protection reasons, or if the beneficiaries are in higher tax brackets than the IRA owner.
- **Life Insurance** – Consider obtaining life insurance to reimburse beneficiaries for their accelerated tax liability.

What Action Should an IRA Owner Take Now?

There is no “one size fits all” estate plan in response to the SECURE Act.

All IRA owners should review their beneficiary designations and estate planning documents, and speak to their financial advisor, accountant, and estate planning counsel to understand how the SECURE Act will affect their plan. A detailed review is especially necessary if an IRA is payable to a trust. In some cases, modifications will need to be made to ensure the IRA owner's wishes will be carried out in a tax-efficient manner.

Please call your estate planning attorney directly or our office at (804) 565-2300 to make an appointment to review your estate plan.