Suddenly *in*secure

In December, as part of the budget deal, the Congress passed the SECURE Act (Setting Every Community Up For Retirement Enhancement Act), and the President quickly signed it. The new legislation included liberalization of retirement plan rules for small employers, repeal of the old rule that those over 70½ are barred from contributing to a traditional IRA, and permission to use up to $10,000 of 529 plan money to repay student loans (lifetime cap, not per year), among other things.

According to the bipartisan Joint Committee on Taxation, the costliest change in terms of lost revenue is an increase in the age at which Required Minimum Distributions (RMDs) must begin. The new age is 72, up from the familiar 70½. This change will "cost" the federal treasury an estimated $737 million in 2020, some $8.8 billion over the next ten years.

The Congress decided to look to those who inherit IRAs and other qualified retirement plan assets to pick up this tab.

An end to stretching

Those who inherit an IRA from someone who died in 2019 or earlier have had the option of taking RMDs over their lifetime, a strategy called the "stretch IRA" by estate planners. This was a great plan for heirs who had no immediate need for the funds, because it maximized the period of tax deferral while it tended to push the largest distributions into retirement, when the heir was likely in a lower tax bracket.

The new rule, when decedents die in 2020 or later, requires that the inherited IRA be paid out in ten years, not over a lifetime. In 2020 this single change is projected to increase federal tax revenue by $212 million. The serious money comes in down the road, because in 2029 federal revenue will be increased by $2.5 billion. Over the ten-year budget window this change raises $15.7 billion, more than enough to offset the "costs" of taxpayer breaks.

Exceptions

There are important exceptions to this new rule. These designated beneficiaries will be permitted distribution periods longer than ten years:

- a surviving spouse;
- a minor child or children;
- a disabled beneficiary;
- a chronically ill individual; and
- beneficiaries who are less than ten years younger than the account owner (such as a brother or sister).

The exception for the minor child lasts only until he or she reaches the age of majority (18 or 21, depending upon state law), because then the ten-year rule kicks in. For the other categories of designated beneficiaries, the exception ends at death when a ten-year distribution must begin.

Action plan

In a recent legal webinar, estate planning expert Natalie Choate called the elimination of the lifetime payout rules "a sucker punch" to taxpayers who relied upon long-settled tax law in crafting their estate plans. The new law "affects not only people who are already dead, it affects the written estate plans that our clients have already made," she said. The impact of the change will vary among families depending upon circumstances. "It's definitely not one-size-fits-all, and there's no one thing you can tell everyone to do," Choate concluded.

For married couples who plan to leave each other their retirement assets, the SECURE Act changes little. A surviving spouse who inherits an IRA may treat the account as his or her own. In that case, penalty-free distributions are generally not permitted before age 59½, and RMDs will commence when the spouse reaches age 72. Alternatively, the surviving spouse may take the role of beneficiary instead of owner, which calls for an immediate program of RMDs geared to the spouse's age.

For nonspouse beneficiaries, a conduit trust has been a popular tool to turn an inherited IRA into a lifetime financial resource. That protection now will last only ten years. An alternative to consider is making a charitable remainder trust the IRA beneficiary. There is no income tax when the IRA money goes to the charitable trust, so the entire resource is available to create an income for the private beneficiary. The income may be expressed as a fixed annual dollar amount (an annuity interest) or as a fixed percentage of the value of the trust assets (a unitrust interest).

If you inherited an IRA before 2020, the new rules don't affect your payouts. But if an IRA makes up a substantial portion of your estate, you should consider scheduling an appointment with your estate planning advisors soon this year. ☐