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REVIEWING ESTATE PLANS AFTER THE SECURE ACT

After enactment of the Setting Every Community Up for Retirement Enhancement Act (the SECURE Act) on January 1, 2020, clients now need to re-examine their estate planning with their advisors with regard to their IRAs and other qualified retirement plans.

As we noted in our last article, InSecure Inheritance Trusts, the SECURE Act ends the "stretch" inherited IRA after a participant's death for all but five types of "eligible designated beneficiaries" (EDBs):

(1) the spouse of the original plan participant;

(2) a person who is 10 or fewer years younger than the original plan participant (e.g., siblings and unmarried partners not more than 10 years younger than the participant);

(3) a child of the original plan participant who is under the age of majority for the period of their minority;

(4) a person who is disabled within the meaning of the Social Security Act; and

(5) a person who is "chronically ill" (e.g., unable to perform at least 2 of certain specified daily living functions for a period of 90 days because of loss of functional capacity).

For all other designated beneficiaries who otherwise would previously have qualified for distributions over their respective life expectancies, **beneficiaries are now required to withdraw all IRA assets from their inherited IRA on or before December 31st of the year that is 10 years after the date of death of the original participant.** We refer to this new SECURE Act requirement as "the New 10 Year Rule."

Because the SECURE Act does not appear to significantly change the way we have always planned for spouses and EDBs who are persons 10 or fewer years younger than the original plan participant, this article focuses on estate planning for beneficiaries other than EDBs. Typically, what needs to be addressed after the SECURE Act involves post-mortem client planning when clients leave IRAs at death for the benefit of adult children, their

descendants, and other beneficiaries who are not EDBs ("non-eligible designated beneficiaries" or "non-EDBs"). In cases where there are children by a prior marriage, this article will also be pertinent to client reexamination of second marriage planning for what will happen at the death of the first decedent of a married couple.

Client discussions with their advisors regarding revised estate planning for IRAs will need to be tailored to their particular priorities and goals. To facilitate such review, clients should now reconsider and discuss a number of pertinent questions focused on their planning for family members other than spouses and other "eligible designated beneficiaries." We address those questions below and planning strategies suggested by the answers. In addition, these answers may suggest new alternative planning ideas for client consideration. We have also created a fillable PDF questionnaire based on this article to assist with your planning.

In our discussions about the SECURE Act with clients, we find that it is often helpful if clients have thought about the following questions:

1. How important is it that your inherited IRA assets be protected from potential beneficiary creditors and divorce and/or from estate taxation at the beneficiaries' respective deaths?

If this is not important, IRA assets can be left directly to individual family members or other non-EDBs who qualify for the New 10 Year Rule without having to encumber Inheritance Trusts for other assets with the limitations of the Conduit Trust or Accumulation Trust rules that are necessary to qualify them as "see-through" trusts.

2. What is the likely value your IRA assets at the time of your death?

The SECURE Act's impacts may be minimal if the total value of IRA assets is less than $100,000 per non-EDB. Even distributions from Conduit Trusts may be acceptable if they are limited to $10,000 to $20,000 per year.

3. What marginal individual income tax brackets are trust beneficiaries likely to be in?

Remember that for Conduit Trusts, determination of the income tax bracket of the individual recipient beneficiary will include the amount of the trust's IRA withdrawal distribution. Using an Accumulation Trust rather than a Conduit Trust will be more advantageous if trust beneficiaries will be in the maximum income tax bracket anyway (either with or without including inherited IRA distributions).

4. Does it matter if your inherited IRAs might be distributed under the Minimum Distribution Period rules?

If it doesn't matter that IRA assets might have to be withdrawn and income taxes paid within a period as short as 5 years, it won't matter that your Inheritance Trust is comprised of only "identifiable individual" beneficiaries to qualify as a "see-through" trust for IRA distributions. In these situations, compliance with either the Conduit Trust rules or the Accumulation Trust shortest life limitations may be unnecessary; and Inheritance Trusts can be structured with the same provisions as are desirable for non-inherited IRA assets.

5. Alternatively, is it important that your Inheritance Trusts have the benefit of at least 10 years to withdraw inherited IRA assets?

Tax-free compounding, even over 10 years, can be a significant advantage, especially for large IRAs. If it is important that Inheritance Trusts qualify for the New 10 Year Rule, they will continue to have to be structured as either Conduit Trusts or Accumulation Trusts with only "identifiable individuals" as beneficiaries.

6. If it is important that Inheritance Trusts qualify for the New 10 Year Rule, should they be Conduit Trusts or Accumulation Trusts?

This will probably depend on your answers to a couple of additional questions:

> **A. How much do you worry about protecting your beneficiaries from claims by potential creditors or divorcing spouses or from future estate taxation when they die?**
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> Given the serious erosion of creditor and divorce protection that may occur with respect to Conduit Trusts within the 10 year period under the New 10 Year Rule, qualifying for "see-through" trust status as an Accumulation Trust may be preferable,

especially if the requirements limiting beneficiary flexibility to add potentially older beneficiaries are withdrawn by the Treasury Department.

B. How important a factor is the Accumulation Trust's maximum income tax bracket?

The answer to this question may depend on the comparative marginal income tax brackets of trust beneficiaries individually. In addition, where Accumulation Trusts were or might be hereafter implemented, the trade-off of paying higher income taxes on inherited IRA withdrawals for Inheritance Trust protections may be acceptable notwithstanding the amount of the taxes payable.

7. Might you prefer to have some or all of your IRA assets go to qualified charities who will not have to pay income taxes on IRA withdrawals rather than to individuals or trusts that will have to incur significant income taxes on the withdrawals?

For the charitably inclined, IRA assets may be the best types of assets to pass to charities, leaving other assets with more favorable (if any) income tax attributes to family members and other intended beneficiaries.

8. If you are somewhat charitably inclined, are you interested in leaving some or all of your IRA assets at death to charitable remainder trusts for your beneficiaries that can stretch income taxation over their lifetimes?

Because they are not required to pay income taxes, charitable remainder trusts (CRTs) can receive IRA assets after your death without having to paying income taxes on them. A CRT can be structured to pay your beneficiary or beneficiaries what is effectively an annual annuity over the course of their lifetime or for a guaranteed period of up to 20 years. The amount of the annual beneficiary distribution must be at least 5% of the initially contributed CRT assets and can be larger depending on the likely period of non-charitable distributions and a requirement that one or more qualified charities must be projected to receive at least 10% of the amount initially contributed to the CRT.

To the extent that CRTs don't have to pay out trust assets, what were formerly IRA assets can be invested to compound tax-free over time and thereby increase future the non-charitable distributions. The trade-off is that your non-charitable beneficiaries must realize income for individual income tax purposes as distributions are made to them. In the case of a CRT

funded with an inherited IRA, everything received by the individual non-charitable beneficiaries would each year be taxed to them as ordinary income for some time. At the end of the period you have designated for the CRT to continue, all remaining CRT assets will pass tax-free to the designated charity or charities. (For a fuller explanation of this strategy, please see our prior articles on CRTs.)

While CRTs emulate the benefits of what were formerly "stretch" inherited IRAs with comparable creditor and divorce protection, individual beneficiaries cannot receive anything other than the specified annual CRT distributions and have no access to other CRT trust principal. While CRT beneficiaries can be nominated to serve as the CRT manager and Trustee, they are limited by number of strict rules precluding them from self-dealing with trust assets. Consequently, you might not want to leave all of your IRA assets to a CRT.

9. Can you obtain replacement life insurance or convert existing term insurance on your life and/or that of your spouse?

If so, you might want to consider obtaining such life insurance and making a number of withdrawals from your IRA assets to pay the premiums for such insurance. Alternatively, if you have convertible term life insurance policies or universal life insurance that is designed to run out before your death, you might want to consider making withdrawals from your IRA assets to pay for converting and continuing such insurance until death. In this fashion, you can make these withdrawals at your current income tax rates and invest these withdrawals in an asset that can be received estate and income tax-free by your Inheritance Trusts. Since these life insurance proceeds will be income tax-free, the Inheritance Trusts need not be "see-through" Conduit or Accumulation Trusts (extent to the extent that they might otherwise receiving other IRA assets). This strategy benefits by minimizing the ultimate income taxes payable on your IRA assets as long as your current tax bracket is less than that of your Inheritance Trust or individual beneficiaries (after the inclusion of the IRA proceeds).

In addition, if your beneficiaries face having to pay estate taxes on your death, such taxes can be avoided by purchasing or owning life insurance using a separate life insurance trust during your lifetime.

10. Are you entitled to contribute to a Roth IRA?

If you have earned income and are eligible to contribute to a Roth IRA, another strategy might be to make a series of relatively small withdrawals from your IRA while you are alive

and then make contributions to a Roth IRA. Such a Roth IRA would be required to be distributed after your death to non-EDB beneficiaries under the same rules as for non-Roth IRAs, but at least these withdrawals would not incur the heavy income taxation that are likely under the New 10 Year Rule or during a Minimum Withdrawal Period.

The problem is that it is difficult to make this strategy work from a tax-savings standpoint unless you are now in a relatively low individual tax bracket and at the same time have earned income sufficient to make the Roth IRA contribution. This strategy loses the time value of monies paid for current income taxes and may require tax-free compounding over a distribution period longer than 10 years after your death to make up for this loss.

As we noted in our last article, the bottom line is that the SECURE Act makes it **imperative** that clients review with advisors what should happen to their IRA assets after their deaths. As suggested above, alternative strategies are available, but whether and the extent to which they are used will depend on individual client answers to these questions about their personal circumstances and goals. Remember to download our fillable PDF questionnaire, Questions to Consider After the SECURE Act, to prepare for meeting with advisors. If you would like to review these questions or reexamine your personal IRA and estate planning with me in light of the impacts of the SECURE Act, please do not hesitate to contact us.