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Estate Planning Flash

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Impact of the SECURE Act: the Stretch is Dead (or is it?)

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The Setting Every Community Up for Retirement Enhancement Act (the "SECURE Act") was signed into law on Dec. 20, 2019, and took effect on Jan. 1, 2020. The SECURE Act expands benefits associated with IRA, 401(k) and other qualified plans, including creation of additional penalty-free withdrawals for birth and adoption costs, deferment of the beginning date for required minimum distributions (RMDs) until an account owner attains 72 years of age (previously 70 ½) and removal of the prohibition of an account owner from making contributions after the age of 70 ½.

Despite these taxpayer-friendly initiatives, however, the SECURE Act also limits an account owner's ability to pass wealth to future generations by eliminating the ability of beneficiaries to withdraw account assets over their lifetime expectancies (known as the "stretch" option).

Under the SECURE Act, non-spouse beneficiaries are required to withdraw the entire account within 10 years of the account owner's death, with narrow exceptions for certain beneficiaries (surviving spouses, minor children, disabled and chronically ill beneficiaries and beneficiaries not more than 10 years younger than the account owner). By some estimates, elimination of the "stretch" option could raise $15.7 billion in revenue over the next 10 years.[1]

Under the prior law, it was often advised to avoid naming a Trust as an outright beneficiary because retirement accounts payable to Trusts that do not qualify as a Designated Beneficiary are required to be distributed within five years of the account owner's death. Naming a Trust as a retirement account beneficiary could now be advantageous, however, because assets held in Trust are typically not subject to a beneficiary's creditors in the event of bankruptcy or divorce.

For individuals who are charitably inclined, a Charitable Remainder Trust (CRT) may be a kind of workaround to mimic the "stretch" and achieve similar tax-deferred growth treatment. Similar to the "stretch," a CRT beneficiary receives a fixed, regular income stream during her lifetime and the assets in the CRT are only taxed when distributed to the beneficiary. Unlike the "stretch," where the remaining balance can be redirected to future generations, the remaining balance of a CRT must be distributed to charity after the Trust term expires. Other well-known estate planning strategies, such as Roth conversions and the use of life insurance, could also serve as attractive options in the wake of the SECURE Act.

In light of these fundamental changes, you should contact a member of the Estate Planning team to discuss whether updates should be made to the beneficiary designations of your retirement accounts.

The information contained herein is based on a summary of legal principles. It is not to be construed as legal advice. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.

1 Gravelle, Jane G. (2019). The SECURE Act and the Retirement Enhancement and Savings Act Tax Proposals (H.R. 1994 and S. 972) (CRS Report No. IF11174). Retrieved from Congressional Research Services website.