Estate Planning Alert

PULLMAN & COMLEY

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New Retirement Distribution Rules Begin in 2020: Planning Considerations and Opportunities

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The first important new law impacting retirement distributions in over a decade was enacted on December 20, 2019 as the SECURE Act ("Setting Every Community Up for Retirement Enhancement Act of 2019"). The Act provides certain beneficial income tax changes for individuals who turn 70½ in 2020 and beyond, but it also imposes harsher tax consequences on non-spouse beneficiaries (such as children and grandchildren) who inherit a retirement account from someone who dies after January 1, 2020.

On the positive side, the Act increases the age when an individual must begin to take required minimum distributions (RMDs) to age 72 (from age 70 ½). This change is effective for any IRA owner who turns 70½ in or after 2020. This will enable individuals to defer distributions (and the taxes due) until age 72.

If an individual turned 70½ in 2019, he or she must take the RMD for 2020 and following years (unless there is further IRS guidance on this in 2020).

The Act also eliminates the maximum age limit for contributions to a traditional IRA if the individual is still working and has earned employment income. Previously, no contribution could be made to an IRA after age 70½.

The foregoing positive changes for taxpayers under the Act are offset by a significant adverse income tax consequence to a beneficiary who inherits an IRA **after January 1, 2020** — if that beneficiary is not the surviving spouse (e.g. a child or grandchild). For these so-called inherited IRAs, the maximum time frame for withdrawing distributions is 10 years after the IRA owner dies. Under prior law, the RMDs could be "stretched" over the life expectancy of the beneficiary. This change means that income taxes paid on those RMDs by the beneficiary will be accelerated during that 10-year period (and the IRS will collect tax revenue a

lot sooner) and the tax-free growth of the inherited IRA will last only a maximum of 10 years, instead of the beneficiary's lifetime.

If a beneficiary inherited an IRA from an individual who died **prior to January 1, 2020**, there is no change to the RMDs. That beneficiary can continue to take withdrawals on the same schedule and stretch out the RMDs.

The Act provides a few specific exceptions to the 10-year withdrawal requirement for inherited retirement benefits, including for a child who has not yet reached the age of majority (which in most cases, the RMDs must be taken by age 28); and, for certain disabled or chronically ill individuals, and individuals who are not more than 10 years younger than the IRA owner (in which cases, the RMDs may be taken over the beneficiary's life expectancy).

To illustrate the Act's impact on beneficiaries, consider the following scenario: if a surviving spouse dies after 2020 and owns a $1 million IRA naming her child (who is over 18 years of age) as the beneficiary, the child will be required to take distributions from the IRA and deplete it over a maximum of 10 years. The child can withdraw equal or unequal amounts, or nothing, in any year so long as the IRA balance becomes zero in the year of the tenth anniversary of the parent's death. This will require the child to undertake complex income tax planning and investment projections over the 10-year period.

Planning Considerations

You should review your retirement and estate planning with an advisor as a result of the Act's changes if:

- You will turn 70 ½ years old in 2020;
- You have designated a child, grandchild, or much younger individual, as the beneficiary of a retirement benefit to take advantage of the former rules to stretch out RMDs over that younger beneficiary's life expectancy;
- You designated a trust as the beneficiary of a retirement benefit;
- You made decisions about the timing of distributions to beneficiaries in your Will or estate planning trust in heavy reliance on the assumption that your beneficiary would elect to take RMDs from your IRA over the beneficiary's lifetime; or
- You are charitably inclined and gifts to charity are an important part of your estate planning and (a) you have not included charities as beneficiaries under your retirement benefit; or (b) you want to stretch out distributions of the retirement benefit to your beneficiaries and also benefit charitable organizations by establishing a charitable remainder trust; or
- You are in a lower income tax bracket than your beneficiaries and want to reduce their tax burden by converting some or all of your traditional IRA to a Roth IRA and pay income taxes upon the conversion.

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