Secure Act Developments

Planning for Retirement Benefits

June 2022

Legislation introduced in 2020 and then expanded and codified earlier this year has strengthened access to qualified retirement savings plans for businesses and employees. It has also complicated the use of such plans as part of an estate planning strategy.

In this piece, we provide an overview of the relevant legislative actions and regulations, implications for both plan participants and their beneficiaries, and strategies to adjust to these changes in an optimal manner.

Part 1: Impact of the Secure Act on Retirement Savings

The Setting Every Community Up for Retirement Enhancement Act (SECURE Act) was signed into law on December 20, 2019, effective January 1, 2020. The bipartisan bill was designed to help Americans save for retirement. The Act:

- made it easier for small businesses to establish 401(k) plans by providing tax credits and protections on collective Multiple Employer Plans;
- removed the maximum age limit on retirement contributions, which had been 70½;
- improved coverage for part-time employees, lowering the number of annual hours required to participate in their employer's retirement plan; and
- raised the trigger age for Required Minimum Distributions (RMDs) from qualified plans and IRAs from 70½ to 72.

Congress included a revenue raiser in the legislation to pay for the changes, significantly curtailing the use of "stretch IRA" estate planning strategies, which enabled beneficiaries to take distributions over their life expectancy. Under the SECURE Act, the life expectancy payout has been replaced by a maximum 10-year post-death payout period for most retirement benefits, except for a select subgroup of beneficiaries.

The SECURE Act added the term "eligible designated beneficiaries" ("EDBs") to describe this subgroup of designated beneficiaries who are still able to take distributions over their lifetime:

1. Surviving spouse;
2. Disabled beneficiary[i];
3. Chronically ill beneficiary[ii];
4. Minor child of the participant; and
5. Not more than 10 years younger individual.

Surviving spouses remain eligible to roll an IRA into their own name. If a spouse rolls it into their own name, an entirely different set of rules applies to them. They are no longer governed by the distribution rules that apply to beneficiaries but rather by the distribution rules that apply to plan participants. They can treat the retirement account as their own for all purposes, which allows them to combine it with their own retirement accounts, do Roth conversions if applicable, and name their own beneficiaries. Furthermore, their own beneficiaries will have their own 10-year (or lifetime depending on their status as EDB) distribution window instead of merely stepping into the shoes of the previous beneficiary.

Part 2: Treasury's Proposed Regulations Relating to the SECURE Act

On February 23, 2022, the Treasury Department released Proposed Regulations relating to Required Minimum Distributions (RMDs) from qualified plans. These Proposed Regulations were released to reflect changes made to the Internal Revenue Code by the SECURE Act.

Note: Calculating RMDs for participants and beneficiaries can be quite complicated:

- Participant RMDs can be affected not just by the participant's age but, in certain cases, by their spouse's age.
- Beneficiary RMDs are dependent on what category of beneficiary they fall into: spouse, non-spousal "eligible designated beneficiaries" (EDBs, described above), designated beneficiaries (DBs) who are not EDBs, and beneficiaries who do not qualify as DBs, such as the participant's estate or a charity.
- Beneficiary RMDs can further differ depending on whether the participant died before or after the SECURE Act became law and before or after their required beginning date ("RBD"), which for participants dying in

10-Year Rule

One of the changes that SECURE made to RMD requirements for plan participants dying in 2020 or later was eliminating the stretch IRA (i.e., life expectancy distributions) for all beneficiaries except EDBs in favor of a 10-year rule. Until the publication of these proposed regulations, most commentators had assumed that no distributions would be required in the first nine years after the applicable event, followed by a 100%-of-the-account RMD in the 10th year (consistent with the statutory methodology of current IRA 5-year payout provisions). However, the Proposed Regulations have clarified that this is not the case and that RMDs must still be taken in each of the nine years leading up to the year 10 deadline if the participant died after their RBD.

If the participant dies before their RBD, then there are no RMDs for years 1-9, but the entire account must be distributed to the beneficiary before the end of the 10th year.

Trusts as IRA Beneficiaries

The Proposed Regulations restate, substantially expand, and clarify the RMD trust rules. They codify the terms See-Through Trust, Conduit Trust, and Accumulation Trust – terms that had been in use for years but had no statutory definition.

See-Through Trust is a trust designated as the beneficiary of a retirement account that meets certain requirements such that the Trust's beneficiaries (and not the Trust itself) are deemed as being the beneficiaries of the retirement account.

Conduit Trust is a See-Through Trust that provides that with regard to the deceased participant's interest in a retirement account, that all distributions will be paid directly to, or for the benefit of, the specified beneficiaries, i.e., that retirement account distributions cannot be retained in trust.

Accumulation Trust is any See-Through Trust that is not a Conduit Trust.

Before the SECURE Act, practitioners commonly avoided naming trusts as retirement account beneficiaries in favor of individuals, as doing so enabled each beneficiary to take distributions over their own life expectancy (rather than the shortest life expectancy among the trust beneficiaries). Additional uncertainty in how potential successor beneficiaries could impact RMDs and other traps for the unwary in naming trusts were easily avoided by simply naming an individual. With the imposition of the 10-year rule for all but EDBs, stretch IRAs are now impermissible for most, so utilizing trusts as IRA beneficiaries will be more attractive. Greater clarity around trust rules due to the Proposed Regulations make them more practical as well.

Part 3: The SECURE Act 2.0

On March 29, 2022, the U.S. House of Representatives passed the Securing a Strong Retirement Act (SECURE 2.0) with a bipartisan vote of 414-5. The Senate version of the bill was introduced on May 20, 2022. While there are differences between the two bills requiring resolution, it is widely believed that SECURE 2.0 will become law in 2022 due to its wide bipartisan support.

SECURE 2.0 is an attempt to encourage retirement savings, improve retirement rules, and lower the employer's cost of setting up a retirement plan. While this new proposed legislation does little to impact the individual planning considerations discussed below, the following provisions could alter select retirement savings plan accumulation and distribution options and strategies:

- Automatic enrollment and escalations in most 401(k) and 403(b) retirement plans. Gradually raise the Required Minimum Distribution age to 75 by 2033.
- Treat student loan payments as elective deferrals for purposes of matching contributions.
- Enhancements to the 50+ retirement plan catch-up limits in select plan types.
- Forced Roth treatment of 50+ retirement plan catch-up contributions (and consequent loss of employee deduction for these contributions) as a revenue raiser.
- Expanded voluntary Roth options for SIMPLE, SEP, and employer matching contributions.
- Minor enhancements to charitable distribution options – inflation indexing, one-time options.
- Eliminate barriers to owning annuities in IRAs.
- Reduce the excise tax on excess accumulations from 50% to as low as 10%.

The Act also includes other technical and administrative provisions to reduce penalties for unintended technical violations, increase flexibility for hardship withdrawals, and minimize the administrative burden on employers establishing retirement plans.

Part 4: Planning Considerations and Opportunities

While the SECURE Act makes qualified plans and IRAs more attractive for retirement planning purposes, it reduces their appeal as an estate planning tool. The 10-year maximum distribution period for most non-spousal beneficiaries may require adult beneficiaries to take inherited retirement account distributions as income during their peak earnings years when they could be in the highest tax brackets of their lives. Below we summarize some key issues to consider and our recommendations in light of the changes outlined above.

Managing Taxes

Generally, the best approach to take with taxable retirement plan distributions (especially over a short time horizon like 10 years) depends on the beneficiary's tax bracket. For beneficiaries who have income that varies substantially from year to year or whose tax burden might be affected by a significant life change (e.g., state of residence, marital status), it makes sense to plan distributions around those circumstances, "using up" low brackets as opportunities arise. For those with stable income or more predictable income growth, taking larger-than-required distributions in earlier years may be more prudent than deferring RMDs until the 10th year.

Protecting Heirs

As noted above, the introduction of the 10-year rule and clarification of the trust-as-beneficiary rules elevate the importance of trust planning for retirement benefits. Trusts can provide asset protection that would otherwise be unavailable if RMDs are made directly to an individual. Accordingly, consider incorporating trusts into an estate plan when beneficiaries are young or financially vulnerable, as segregating assets into trusts may help shield them from financial harm.

Balancing Risks

Another planning consideration with trusts—one that may conflict with its asset protection benefits—is managing the tax brackets of the individual and trust. Using Conduit Trusts, which force retirement account distributions out to beneficiaries, can avoid punitive compressed trust tax brackets. Alternatively, using an Accumulation Trust and granting the trustee the power to distribute among beneficiaries at the trustee's discretion can provide a more sophisticated trustee greater planning flexibility by allowing them to optimize for both tax management and asset protection considerations.

Incorporating Charity

Another increasingly popular technique following the SECURE Act for larger retirement accounts is incorporating Charitable Remainder Trusts ("CRTs"). In this scenario, the plan participant names the CRT as the plan beneficiary, to be funded by a lump-sum distribution upon the participant's death. The CRT pays no income tax at funding, and the estate receives a charitable deduction for the actuarial value of the remainder interest passing to charity. The CRT pays a percentage interest

(for example, 6% of the trust balance) each year for the lifetime of the named beneficiary, with all remaining funds passing to the charity(ies) designated by the original owner.

While this structure has the potential to synthetically replicate the pre-SECURE lifetime payout tax deferral economics, the charitable carve-out is material (at least 10% of the value at funding), so the strategy may only appeal to taxpayers with sincere philanthropic intent. Further, non-charitable payouts are typically structured for a period of time measured by the lifetime of the beneficiary. If the lifetime beneficiary dies prematurely, the entire remaining balance passes to charity and not to the beneficiary's heirs.

Action Required

The SECURE Act, Proposed Regulations, and other pending legislation have significantly altered the fundamental assumptions, principles, and economics of estate planning with retirement benefits. We encourage all retirement plan owners to work with their client service team to review existing plan beneficiary designations and current estate planning provisions in light of these changes.

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[i] Within the meaning of Sec. 72(m)(7): “For purposes of this section, an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require.”

[ii] Within the meaning of Sec. 7702B(c)(2): “(A) In General - The term “chronically ill individual” means any individual who has been certified by a licensed health care practitioner as — (i) being unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days due to a loss of functional capacity, (ii) having a level of disability similar (as determined under regulations prescribed by the Secretary (in consultation with the Secretary of Health and Human Services) to the level of disability described in clause (i), or (iii) requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment. Such term shall not include any individual otherwise meeting the requirements of the preceding sentence unless within the preceding 12-month period a licensed health care practitioner has certified that such individual meets such requirements. (B) Activities of daily living For purposes of subparagraph (A), each of the following is an activity of daily living: (i) Eating. (ii) Toileting. (iii) Transferring. (iv) Bathing. (v) Dressing. (vi) Continence.”