SECURE Act: Significant Changes to Beneficiary Distributions

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The SECURE Act – the “Setting Every Community Up for Retirement Enhancement” Act – was signed into law by President Trump on December 20, 2019. The law generally took effect on January 1, 2020.

The SECURE Act encompasses a lot of changes to retirement assets, including changes to the rules for distributions of inherited retirement assets, the postponement of the Required Beginning Date (now April 1 of the year after the year in which you turn 72), and the elimination of the age limit for contributing to a traditional IRA.

This post focuses on the changes to the rules for distributions from inherited retirement assets. These new rules apply to most types of retirement assets, including 401(k) plan accounts, individual retirement accounts, individual retirement annuities, qualified trusts, certain annuity contracts, and certain defined compensation plans.

The changes to the rules are important to anyone who hopes to leave funds to heirs in a retirement account or who has significant balances in their accounts presently. Additionally, unique planning opportunities are available to some who have inherited retirement assets from decedents dying on or after April 1, 2019, and before January 1, 2020, by deciding whether to disclaim some or all of such interests within nine months after date of death.

New Ten-Year Rule: Under the SECURE Act, the general rule for distribution of an inherited retirement asset to a Designated Beneficiary (any individual designated as a beneficiary by the participant / owner) requires that the entire balance of the asset be distributed within ten years of the death of the participant / owner if the participant / owner, or the initial beneficiary of an inherited account, dies after December 31, 2019. There is no requirement that distributions be taken every year or in any particular amount, so long as the entire account is distributed by the end of the ten-year period following the death of the participant / owner. Going forward, most beneficiaries (other than Eligible Designated Beneficiaries, discussed below) will no longer be permitted to take minimum distributions based on their life expectancies to take advantage of the “stretch” that previously allowed for longer tax-free growth and minimization of the tax effects over time.

Old Rules Continue for Current Beneficiaries: Beneficiaries of retirement assets inherited from a participant / owner who died before January 1, 2020, continue to use their life expectancies and take required minimum distributions as previously required.

Five-Year Rule Still Applies: If there is no Designated Beneficiary of a retirement account (either no beneficiary designation has been made or the beneficiary is the estate of the participant / owner, a charity, or another non-individual), the old rules still apply, and if the participant / owner had not reached the required beginning date (RBD), the entire account balance must be distributed by the end of the fifth year following the year of the death of the participant / owner. If the participant / owner died after the RBD, his/her life expectancy based on the single life mortality table may be used, subtracting one for each subsequent year.

Eligible Designated Beneficiaries: There are important exceptions to the general ten-year rule for individuals who are “Eligible Designated Beneficiaries,” including (i) the surviving spouse, (ii) a child of the participant / owner who has not reached the age of majority, (iii) a disabled individual, (iv) an individual with a chronic illness (defined by statute), and (v) individuals who are no more than ten years younger than the participant / owner.
Surviving Spouses: Surviving spouses still have the special benefits that they previously enjoyed, including the ability to rollover their deceased spouse’s account into his/her own, to treat the account as his/her own account, or to defer required distributions from the inherited account until the decedent would have reached the Required Beginning Date. If the surviving spouse keeps the retirement account as an inherited account, he/she can use his/her life expectancy to calculate required minimum distributions.

Minor Children: While the child of the participant / owner is still a minor, he/she may use his/her life expectancy to determine required minimum distributions. Once the child reaches the age of majority, the ten-year rule applies. Such minor children, therefore, can defer the start of the ten-year period for distributions until they reach the age of majority.

Disabled or Chronically Ill: Disabled and individuals with a chronic illness can also use their life expectancies to calculate required minimum distributions, and they have special rules for when retirement accounts are payable to trusts created for their benefit.

Comparable Aged Beneficiaries: Beneficiaries who are no more than ten years younger than the participant / owner can also use their life expectancies to calculate required minimum distributions. This rule may benefit, for example, unmarried partners or the siblings of the participant / owner named as beneficiaries.

Successor Beneficiaries and the New Rules: At the death of the Eligible Designated Beneficiary, however, the new ten-year distribution period applies to Designated Beneficiaries.

Trusts: The specific rules that will apply to trusts (other than trusts for a disabled or chronically ill individual) are uncertain, but the Act gives no specific reason that the prior rules that make trusts either a conduit trust or accumulation trust will no longer apply, although the new ten-year rule will apply.

Disclaimer Option: For beneficiaries of decedents dying after March 31, 2019, and on or before December 31, 2019, there is a narrowing window to disclaim the retirement assets to achieve more appropriate results. The rules for disclaimers must be considered, and the decision must be made promptly – this window closes for all beneficiaries on or before September 30, 2020.

Action Plan: Everyone with a retirement asset should immediately confirm the current beneficiary designation and determine what will happen under the new rules. If any doubt exists as to whether the result is acceptable, gather the documents necessary to evaluate and correct the situation (plan documents for an ERISA plan account (401(k), 403(b), etc.), IRA contracts, copies of current beneficiary designations, and forms to change the beneficiary designation). Contact your estate planning advisors to determine how to be certain that your beneficiary designation will carry out your intent, whether to minimize tax consequences or to control distributions to beneficiaries.

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