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SECURE ACT Transforms Estate Planning for Retirement Benefits
&
Significant Estate Planning Changes for 2020

Family Wealth Planning Group

With the new year come new changes to consider in estate planning. For this client alert, we bring your attention to three topics:

1. New Rules for Inherited Retirement Benefits May Require Reconsideration of Estate Plans
2. Maintained Annual Exclusion and Increased Unified Exemption Continue to Be Helpful For Planning
3. Considerations for Estate Planning Presented by Future Law Changes

1—New Rules for Inherited Retirement Benefits May Require Reconsideration of Estate Plans

Signed into law at the end of 2019, the federal SECURE Act makes important changes in the rules governing retirement accounts (such as IRAs and 401k accounts), effective January 1, 2020. Notable changes affecting individuals include (1) an increase in the age (from 70 ½ to 72) at which required minimum distributions ("RMDs") must begin and until which contributions may be made, and (2) a shortened time period over which most inherited retirement accounts must be distributed to beneficiaries other than a surviving spouse (who remain eligible for "rollovers" into their own, non-inherited plans). The latter change may require some reconsideration of estate plans. It does not alter the RMD rules for retirement accounts already inherited before 2020; rather, it affects those inherited after 2019.

Prior to the SECURE Act, many estate plans incorporated retirement account "stretch" provisions. These provisions allowed retirement plan distributions to a deceased participant's individual beneficiaries to be made ratably over actuarial life expectancies. Deferring distributions from the retirement plans in this manner enabled the undistributed balances of inherited IRAs to continue growing tax-free, and beneficiaries' income tax liability could be deferred ("stretched-out").

Under the SECURE Act, almost all retirement accounts that are inherited by a participant's children or other beneficiaries now must be fully distributed over a maximum period of ten (10) years (presumably measured from December 31 of the year in which the participant's death occurred). A five-year maximum applies to retirement accounts inherited by certain trusts. There are exceptions permitting longer terms (based upon life expectancies) for spouses and certain other beneficiaries , for example, children of a participant (so long as they are minors) and certain disabled or chronically ill beneficiaries or trusts for their benefit. Longer terms are *not* permitted for plan balances inherited by grandchildren, nieces, or nephews.

To take advantage of the favorable "stretch-out" distribution rules that existed prior to 2020, account owners often named their descendants as direct beneficiaries of their retirement accounts, outright and free of trust. This approach had the disadvantages of exposing the retirement assets to the beneficiaries' potential creditors and spendthrift habits. Alternatively, to address such concerns, some clients have designated "conduit" trusts as beneficiaries of their retirement accounts, which trusts will simply "pass through" to beneficiaries all distributions received from the retirement plans. A "conduit" trust was intended to take advantage of the stretch-out while otherwise keeping a trust structure for the balance of the retirement account.

The new compressed time period over which RMDs must be taken from inherited IRAs is a significant change that, for many, will require rethinking estate plan provisions for retirement accounts. Conduit trusts, for example, may not work as intended, causing too many distributions to occur too soon. We would be happy to assist you in determining how your estate plan should handle retirement accounts under the new law.

2—Maintained Annual Exclusion and Increased Unified Exemption Continue to Be Helpful For Planning

Under current law, the exemptions under the estate and gift tax are adjusted each year for inflation. The following applies for donors or decedents who are resident in or citizens of the U.S.:

Exemption	2020 (current year) limit	2019 (prior year) limit
Unified exemption amount[1] (applying to both gift and estate tax)	$11,580,000 ($23,160,000 for married couple)	$11,400,000 ($22,800,000 for married couple)
Generation-skipping transfer tax (GST) exemption amount	$11,580,000 ($23,160,000 for married couple)	$11,400,000 ($22,800,000 for married couple)
Annual exclusion (per recipient, only for gifts for which the recipient can access the use and benefits with sufficient freedom)	$15,000 ($30,000 for married couple)	$15,000 ($30,000 for married couple)

[1] This client alert refers to this amount by the name "unified exemption," while the gift and estate tax statutes themselves refer to this amount by the name "basic exclusion amount." It is important to realize the amount acts by reducing the tax base, and is not a credit against tax.

3—Considerations for Estate Planning Presented by Future Law Changes

Clients should be aware that the unified and GST exemption amounts were only *temporarily* doubled as a result of the 2017 tax act. The higher exemption amounts are scheduled to be cut back by half in 2026. However, depending on the 2020 election results, change could occur sooner.

Following are some effects of the scheduled unified exemption reduction:

- **Gifts first reduce unified exemption amounts that survive the cutback.** If a donor gifts $4,000,000 while the unified exemption is $11,580,000, and the exemption is thereafter reduced to $7,000,000, that donor will have only $3,000,000 of exemption remaining. The effect is that lifetime gifts count first against exemption amounts surviving the cutback.

- **No "clawback" of higher exemption amounts used before cutback.** What if a donor gifts $8,000,00 while the unified exemption is $11,580,000, but dies when the unified exemption is only $7,000,000? A theoretical possibility was that the gifted amounts exceeding the unified exemption at death ($1,000,000 of the $8,000,000) would be taxed at death (i.e., "clawed back"), even though shielded from transfer tax during life. Fortunately, the IRS has confirmed that clawbacks will not occur; thus, under the foregoing facts, all $8,000,000 of gifts would remain exempt from estate tax on death.

Clients should remain alert for potential tax legislation proposed by presidential candidates, including wealth taxes and provisions targeting popular estate planning techniques. Clients may wish to consider gifts to utilize the current exemption amounts before the new Congress is convened in January 2021. If you have any questions or concerns about your estate plan and whether you should make any changes, please contact us.