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Impacts of the SECURE Act & the "Stretch IRA"

The Setting Every Community Up for Retirement Enhancement (SECURE) Act became effective January 1, 2020. How does this new law affect you with regards to the "Stretch IRA"?

What's in the past…

Prior to 2020, IRA and ROTH accounts could be used as a powerful tool for estate planning. Under the old rules, the beneficiary could step into the place of the original beneficiary. If the deceased hadn't hit age 70.5 yet, the required minimum distributions (RMDs) could be delayed until the beneficiary hit that age. If RMDs had been triggered for the deceased, the beneficiary could take the RMDs over their remaining life expectancy – both situations allowing for that "stretch." If you have an established Inherited IRA prior to 2019, you are grandfathered in – you get to keep your "stretch" but only until your demise. Once you pass, your successor beneficiaries will be subject to the new law.

This "stretch" provided an opportunity for parents and grandparents to name children and grandchildren as the beneficiaries, allowing them to pass down wealth to future generations and have the money distributed, potentially, over a long period of time (ex: grandparent leaves IRA to grandchild and the grandchild's stretch is 60 years).

Many named a trust as the beneficiary so that a trust could specify how the distributions would happen. The most common scenario we saw in these types of trusts were for assets to be distributed at specific ages – for example, if there were children, you might see 1/3 be distributed upon the age of 30, another 1/3 distributed at the age of 40, and the final 1/3 distributed at the age of 50. The motivation behind this was to prevent younger beneficiaries of burning through the entire inheritance if it was received in one lump sum. These types of trusts will not work well with the new law.

Now it's 2020…

Moving ahead, Inherited IRA and ROTH accounts will have new rules to follow, most notably the "10-Year Payout Rule". This rule will apply if the owner passed away in 2019 and Inherited IRAs were not established until 2020 – it's tied to when the IRA changes ownership. Now, if someone inherits an IRA or ROTH IRA, the account must be paid out in 10 years. It can be an annual distribution, once every 2 years, or even a lump sum at the end of 10 – you get flexibility in that – but it must be fully distributed by 10 years or a 50% penalty will be imposed.

There are a limited number of "Eligible Designated Beneficiaries", also known as EDBs, that can stretch the payments:

- Surviving spouses
- Minor children of the account owner until age of majority – the 10-year distribution kicks in at that time
- Disabled individuals
- Chronically ill individuals
- Beneficiaries not more than 10 years younger than the IRA owner

Notice that grandchildren are not on this list – which means they are in the immediate 10-year distribution group. A trust that was set up to shelter those monies won't work – it is not one of the approved EDBs and monies must be distributed to beneficiaries by the 10th year.

Clear as mud, right? Our recommendations would be to 1) review the beneficiaries on your IRA and ROTH accounts, and then, 2) review your estate plan or trust documents to see if anything needs to be amended. We're here to help – give us a call and we'll be happy to sit down and talk through any issues, ideas, concerns, and changes you want to make.

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