FOLEY
FOLEY & LARDNER LLP

SECURE Act Closes Stretch IRA Loophole

Michael Schwartz, Jamil G. Daoud
06 January 2020

On December 20, 2019, President Trump signed into law the Setting Every Community Up for Retirement Enhancement Act (the "Secure Act"), effectively closing the tax loophole known as the "stretch IRA." The "stretch IRA" loophole has existed for over twenty years, and its closure could result in a significant tax increase for individuals inheriting 401(k) accounts and Individual Retirement Accounts ("IRAs") after 2019. Other provisions of the Secure Act serve to benefit participants of these accounts, as Congress has recognized the need to assist the average worker with saving for retirement. The Secure Act became effective January 1, 2020.

Closing of the "Stretch IRA" Loophole

By way of background, the federal tax code generally requires the account holder (also referred to as the "participant") of a 401(k) or an IRA to begin withdrawing required minimum distributions ("RMDs") in the year of the participant's required beginning date ("RBD"). Under prior law, the RBD was the year in which the participant turned age 70.5. As explained further below, the RBD has now increased to the year in which the participant turns age 72. (Please note, that 401(k) participants 72 years of age or older may continue to delay their RBD until they retire.) After the participant reaches the RBD, he or she must begin withdrawing RMDs from the account based on his or her remaining life expectancy. This area of the law remains unchanged by the Secure Act.

The key change in the tax code relates to how quickly a beneficiary of a 401(k) or an IRA must withdraw the RMDs from the account. Prior to the enactment of the Secure Act, the beneficiary of an account could "stretch" the RMDs from the account over the beneficiary's own life expectancy. The Secure Act now generally requires the beneficiary of an IRA to withdraw the RMDs from the account within ten years of the participant's death.

However, as with most provisions of the tax code, the Secure Act provides for some notable exceptions to the ten-year withdrawal rule. Most importantly, the new ten-year withdrawal rule does not apply to spousal rollovers. A surviving spouse may continue to roll-over the deceased spouse's account into his or her own IRA, and withdraw the RMDs in accordance with the surviving spouse's own life expectancy. The ten-year rule also does not apply to a chronically ill beneficiary, a beneficiary with special needs, a beneficiary within ten years of age of the participant, and a minor beneficiary. However, the ten-year rule will apply to a minor beneficiary after the minor attains the age of majority.

The new ten-year distribution period will certainly serve as a tax revenue accelerator for the federal

government, but it also could increase taxes owed by account beneficiaries. The Secure Act could drive account beneficiaries into higher marginal tax brackets, as they are required to withdrawal larger RMDs over the condensed ten-year period.

Potential Adverse Impact on Estate Planning

Participants with "conduit trust" provisions in their estate planning documents should revisit and consider revising their documents immediately. A common estate planning strategy used by participants involves designating a revocable trust (or testamentary trust) as the beneficiary of a 401(k) or an IRA. Such a designation allows the trustee of the trust to hold the account for the benefit of the trust beneficiaries after the participant's death and to withdraw the RMDs from the account as they become due.

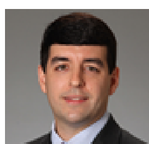
Often the trust agreement will contain what is known as a conduit trust provision. A conduit trust provision requires the trustee to withdraw the RMD from the account each year and distribute the RMD directly to the trust beneficiary. Under prior law, the participant may have been comfortable with the conduit trust provision, knowing that the RMDs would be withdrawn and distributed over the beneficiary's presumably longer life expectancy. However, the Secure Act will now likely require the trustee to fully distribute the account to the beneficiary within ten years. This may not be desirable for participants with significant account balances and young and/or irresponsible trust beneficiaries. One alternative could be to structure the trust as an "accumulation trust," which would permit the trustee to withdraw the RMDs from the account and retain the withdrawn proceeds in the trust. However, one should exercise caution when structuring a trust for a spouse who is beneficiary as special RMD rules may apply.

Account holders should consult with their estate planning attorneys to determine if any revisions are warranted after passage of the Secure Act.

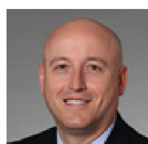
Other Notable Provisions

The Secure Act also contains other notable provisions relating to 401(k) accounts and IRAs that are beneficial to participants. These provisions include, but are not limited to, the following:

- The age at which a participant is required to begin withdrawing RMDs has been increased from 70.5 to 72;
- The prior law's prohibition of contributions to an IRA after the age of 70.5 has been removed, which means that a participant may now contribute to an IRA at any age provided the participant has earned income;
- Beneficiaries of §529 plans are permitted to withdraw up to $10,000 from such plans to repay student loans; and
- Participants that are under the age of 59.5 are permitted to make an early withdraw of up to $5,000 from their 401(k) or IRA to offset the costs of child delivery or adoptions without incurring the 10% early withdraw penalty.



Michael Schwartz
Associate, Tampa
mschwartz@foley.com
813.225.4172



Jamil Daoud
Of Counsel, Tampa
jdaoud@foley.com
813.225.4188