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The SECURE Act: Trust Planning for Inherited IRAs

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A common estate planning technique for clients with substantial retirement plan assets is to name a trust as the beneficiary of those assets. Trusts holding an inherited IRA, for example, can provide the typical controls and protections that make trusts desirable: asset protection from creditors, centralized asset management, and ensuring that a beneficiary (such as a child or grandchild) does not receive a substantial and immediate outright gift. The SECURE Act may upend a number of these goals where IRAs are directed to existing trusts.

> ***I previously named a trust for my children as the beneficiary of my retirement accounts. How does the SECURE Act affect my planning?***

Under previous law, a non-spouse beneficiary could take distributions from an inherited IRA over the beneficiary's life expectancy, resulting in favorable income tax deferral (the "stretch"). Under the SECURE Act, however, the "stretch" for most non-spouse beneficiaries has been reduced to a 10-year term. Put simply, the SECURE Act requires that most retirement assets inherited in 2020 and beyond be distributed at the end of a 10-year period.

Historically, where retirement assets are directed to a trust, the trust beneficiaries could get the benefit of a stretch, provided the trust was properly drafted. For a trust to have qualified for the stretch, the trust must have been drafted as a "see-through" trust. There are two types of see-through trusts: "conduit" trusts and "accumulation" trusts. The greatest impact of the SECURE Act will be on conduit trusts.

Conduit trusts are trusts designed to force out all IRA distributions (RMDs) to the trust beneficiaries. In other words, whenever a distribution is made from the IRA to the trust, the trustee must immediately distribute the IRA proceeds to the trust beneficiary. Under the SECURE Act, these trusts present a new problem: if an IRA has substantial value and must pay out the entire account by the end of a 10-year period, then a beneficiary of a conduit trust will receive a distribution that is much greater than what was intended – specifically, the entire value of the IRA by the end of the 10-year period.

The alternative to conduit trust planning is "accumulation" trust planning. An accumulation trust gives

the trustee discretion on whether to pay out or retain RMDs within the trust. For that reason, an accumulation trust can solve the problem of the trust beneficiary receiving an unexpectedly large distribution, along with the risk of creditors accessing those assets. However, depending on the particular drafting of the accumulation trust, it could be less income tax efficient. This is because IRA distributions generate an income tax burden, and income accumulated within a trust often is taxed at the top income tax rate. An accumulation trust could be drafted to give the trustee discretion to distribute RMDs, and that discretion could be used to spread some of the tax burden to the recipients. Accordingly, the current thinking is that most retirement plans payable to a trust should aim to qualify as an accumulation trust, giving trustees discretion to make more tax-efficient distributions.

In short, if you have designated a trust as the beneficiary of your retirement accounts, you should review the drafting of that trust with your estate planning attorney to understand the implications of the SECURE Act. With careful attention by your estate planning attorney, a trust can be designed to hold an IRA that need not distribute all IRA withdrawals within 10 years and may instead accumulate those withdrawals. Any existing trusts may require modification.

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