Estate plans after SECURE: retirement benefits payable to trusts

Aimed at increasing access to tax-advantaged accounts and preventing older Americans from outliving their assets, the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) is far-reaching retirement savings legislation that took effect in January 2020.

One significant provision eliminated stretch IRAs as an estate planning tool by requiring full distribution of an IRA to beneficiaries within 10 years, following the year of the employee or IRA owner's death.

Now is the time to talk to your financial professional about your estate plans and discuss new options to help you pass your legacy to your beneficiaries without also passing a big tax bill.

URGENT – review existing trusts now

For decades, a popular estate planning strategy for individuals with substantial IRA and other retirement plan assets was to "stretch" the post-death payout period over the beneficiary's life expectancy to minimize income taxes and preserve the tax-deferred status of the undistributed plan assets. Often, investors named a testamentary irrevocable trust ("see-through trust") for the benefit of their spouse, children or grandchildren rather than name the individual outright as the beneficiary of their retirement accounts, due to concerns over potential divorce, lawsuits, financial mismanagement or other missteps.

Prior to SECURE, if the trust satisfied the IRS's requirements to qualify as a see-through trust and all countable beneficiaries were individuals, it was considered a designated beneficiary, and the oldest trust beneficiary's life expectancy was used to determine the payout period (applicable distribution period) for purposes of required minimum distributions (RMDs).

In general, with the passage of the SECURE Act, the life expectancy payout option for any designated beneficiary, including see-through trusts, was eliminated. This was replaced with a 10-year payout rule that requires the investor's entire retirement account to be distributed within 10 years, following the year of their death.

After SECURE – see-through trust issues

Conduit trust

The new legislation may be most problematic for individuals with conduit trusts because the conduit trust will no longer operate the way they originally expected it to work. Under a conduit trust, the trustee immediately pays all retirement plan distributions to the primary or lifetime trust beneficiary ("conduit" beneficiary). All retirement plan distributions paid to the trust are forced out to the conduit beneficiary and nothing accumulates in the trust.

Historically, conduit trusts regulated and controlled the systematic and gradual payout of the investor's sizeable retirement plan over the beneficiary's lifetime. They were used to address fears regarding the beneficiary's potentially questionable financial judgment, discipline and restraint as well as concerns about creditors' and other claimants' (ex-spouses) attempts to access those assets, if otherwise, left outright the beneficiary.

Not a deposit
Not FDIC-insured
Not insured by any federal government agency
Not guaranteed by any bank or savings association
May go down in value

Insurance products issued by:
The Lincoln National Life Insurance Company

SECURE mandates the trustee accelerate distributions under the 10-year payout rule to the conduit beneficiary rather than make small incremental distributions over the beneficiary's lifetime unless the beneficiary is an eligible designated beneficiary (EDB). An EDB is a surviving spouse, a disabled or chronically ill individual, minor child of the investor, or an individual who is not more than 10 years younger than the investor.

As a result, SECURE may expose a conduit beneficiary to an increased income tax burden and undermine the intent, purpose and utility of the trust if the designated beneficiary is not an EDB. At a minimum, individuals should have their conduit trust reviewed and either modified to name an EDB, if appropriate for their circumstances, or potentially switch to an accumulation trust.

Accumulation trust

With an accumulation trust, the trustee has broad discretionary authority to either pay out or accumulate retirement plan distributions during the lifetime of the primary beneficiary for possible distribution to another beneficiary, at a later date. However, after SECURE, even an accumulation trust isn't the perfect solution. It has its tradeoffs.

An accumulation trust may resolve concerns about the beneficiary receiving too much too quickly, but at a prohibitively expensive income tax hit. SECURE requires that all retirement benefits be paid to the accumulation trust within 10 years, following the year of owner's death. To the extent the trustee accumulates retirement plan benefits in the trust, they will be taxed at the highest trust rates due to its compressed tax brackets.

Yet, a strategy that combines an accumulation trust with the purchase of a life insurance policy may be the right solution and should be discussed with your financial professional to help offset the accelerated tax liability with an income-tax free death benefit at death.

Questions to consider

- When was the last time you reviewed your trust to make sure changes in laws don't affect your planning?
- Are you aware that the passage of the SECURE Act may have created drawbacks to your current trust?
- The SECURE Act has significantly changed how certain beneficiaries receive an inherited IRA. Who are the beneficiaries to your trust?
- Does your trust include use of a stretch IRA? If so, it's important we review the trust to ensure there isn't a major income tax burden to your beneficiary.

For individuals with see-through trusts, SECURE may affect existing estate plans.

Now is the time to have your trusts immediately reviewed to accommodate the new law. Contact your Lincoln representative for more information.

This is intended for educational purposes only and must not be considered financial, tax or legal advice. Please work with your financial professional prior to making any decisions regarding your finances.

Lincoln Financial Group® affiliates, their distributors, and their respective employees, representatives and/or insurance agents do not provide tax, accounting or legal advice. Please consult an independent professional as to any tax, accounting or legal statements made herein.

Not a deposit
Not FDIC-insured
Not insured by any federal government agency
Not guaranteed by any bank or savings association
May go down in value

©2023 Lincoln National Corporation

LincolnFinancial.com

Lincoln Financial Group is the marketing name for Lincoln National Corporation and its affiliates.

Affiliates are separately responsible for their own financial and contractual obligations.

LCN-5765738-062123
POD ADA 7/23 **Z02**
Order code: LIF-TAX-FLI021

Lincoln Financial Group®