SPRING 2023

Securing a Strong Retirement Act of 2022

# planning matters

## PRACTICAL INSIGHTS INTO ESTATE PLANNING & WEALTH PRESERVATION

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## MEET THE PLANNERS

**John R. Blasi, Esq.**
Westfield
jblasi@lindabury.com

**James K. Estabrook, Esq.**
Westfield
jestabrook@lindabury.com

**David G. Hardin, Esq.**
Summit
dhardin@lindabury.com

**Mary Patricia Magee, Esq.**
Red Bank
mmagee@lindabury.com

**Elizabeth Engert Manzo, Esq.**
Westfield
emanzo@lindabury.com

**Elizabeth Candido Petite, Esq.**
Westfield
epetite@lindabury.com

**Anne Marie Robbins, Esq.**
Westfield
arobbins@lindabury.com

**Maggie Spaziani, Esq.**
Red Bank
mspaziani@lindabury.com

# securing a strong retirement act of 2022

Mary Patricia Magee, Esq.

**The goal of this article is to highlight some of the changes to the rules governing retirement account distributions under the Securing a Strong Retirement Act of 2022 (aka SECURE 2.0). The positive changes include the following:**

- The age at which one must withdraw required Minimum Distributions (RMDs) has increased to age 73 effective January 1, 2023; it increases again to age 75 effective January 1, 2033;
- The penalty (excise tax) for failure to make a timely withdrawal is reduced to 25% from 50% and, in some cases, to 10%;
- In addition to the ability to exclude $100,000 per year from income where a payment is made directly from the IRA to a charitable organization, an individual is allowed to make a one-time distribution not to exceed $50,000 to a charitable gift annuity, which presents a simple but effective gifting opportunity;
- There are now additional exceptions to the 10% premature distribution penalty; and
- Beginning in 2024, 529 Plan beneficiaries may roll over contributions from a 529 account to a Roth IRA under certain circumstances.

While all of the above changes are beneficial, there are some changes that are not. The balance of this article will focus on the new and substantial limitations on the ability of a beneficiary of a retirement account or IRA to "stretch" out the withdrawals she must make. A beneficiary will fall into one of three broad categories: She may be a "Designated Beneficiary," a "DB," who must withdraw the balance of the account within the 10 years following the employee's death. Or, she may be an "Eligible Designated Beneficiary," an "EDB," who may qualify for a greater than 10-year withdrawal period, or she may be a "Non-Designated Beneficiary," a "Non-DB," who will be required to withdraw the account within 5 years of the account owner's death. This article refers to the date by which the account must be completely withdrawn as the "outside date."

In addition to identifying the outside date by which the account must be withdrawn, there are also situations where beneficiaries, regardless of status, must make annual withdrawals.

Mandated annual withdrawals depend on whether or not the deceased account owner (sometimes referred to as the "owner," "participant" or "employee") had attained his required beginning date at the time of death. In other words, was the deceased account owner taking required minimum distributions ("RMDs") at the time of death? If the deceased account owner had not reached her required beginning date at the time of passing, then many of the classes of beneficiaries need not make annual withdrawals from the inherited account so long as they withdraw the entire account by the outside date. If, however, the account owner had attained, at death, an age where RMDs had to be taken, then a beneficiary must continue to make annual withdrawals based upon the greater of the beneficiary's life expectancy or the owner's life expectancy, depending on the beneficiary's status as a DB, an EDB, or a Non-DB, and must

withdraw the entire account within 10 years following the account owner's death.

The most significant change in the rules is that Designated Beneficiaries, with certain exceptions described below, are no longer entitled to "stretch out" the mandatory withdrawal payments over their lifetimes. The most common type of Designated Beneficiary is an adult who does not have any special considerations. Unless a beneficiary falls into one of the following groups, she will be required to withdraw the full account no later than 10 years following the death of the account owner. The five categories of beneficiaries who have preferred withdrawal periods are referred to as EDBs, and include the surviving spouse, a minor child (defined as an individual who has not yet attained 21 years of age), a disabled individual (think Social Security standards), a chronically ill individual (usually unable to work and suffering from an impairment likely to end with death), and lastly, a beneficiary who is not more than 10 years younger than the deceased account owner.

The most common EDB is a spouse. Spouses who are named as beneficiaries of retirement accounts continue to enjoy the right to make withdrawals over their own life expectancies. While a surviving spouse will most likely elect to roll over the retirement account into his or her own retirement account, there are situations where the opening of an inherited account makes sense, such as when the surviving spouse needs the income and has not yet reached the age where withdrawals may be made without a penalty.

Another EDB is a minor child of the participant. A minor child is defined as an individual who has not yet attained 21 years of age. In that case, from the account owner's death until the EDB attains age 21, mandatory annual distributions will be calculated based upon the minor child's life expectancy. Given that a minor child will have a significantly longer life expectancy at the time of his parent's death, the plan allows for a much smaller annual withdrawal than the parent would have had. Once the child beneficiary attains age 21, he will be required to withdraw the balance of the inherited IRA over the next succeeding 10 years. Since, in most cases, the IRA should not be payable to the minor child individually but rather to a trust for that child's benefit, these relatively straightforward rules may be applied differently if, as in many cases, the minor child has siblings who are also beneficiaries of that trust. In that case, if there is only one trust for all of the children, the rules require that withdrawals be made annually using the life expectancy of the oldest child/trust beneficiary, who would have the shortest life expectancy. This can be a disadvantage for the beneficiary who is significantly younger than his oldest sibling. To avoid this result, separate trusts may be created for each child; however, since each trust will have its own expenses and complexities this approach may not be warranted. It bears mentioning that a minor beneficiary qualifies as an EDB only if he is the child of the original account owner—a minor grandchild does not qualify as an EDB.

SECURE 2.0 also made favorable changes in the case of a disabled or chronically ill beneficiary who qualifies as an EDB. In that case, the beneficiary, or a trust for the beneficiary, must make annual withdrawals over the disabled beneficiary's life expectancy, regardless of whether the account owner had reached his Required Beginning Date ("RBD") at the time of his death. In the case of a trust, however, the trustee need not pay out the withdrawal to the disabled person but rather may accumulate the mandatory withdrawals in the trust. Further, SECURE 2.0 eliminates the concern that the age of the remainder beneficiary (who takes on the death of the EDB) will have a negative impact on the calculation of the annual withdrawals. The annual withdrawals will be based on the disabled/chronically ill beneficiary's life expectancy. In addition, under SECURE 2.0, a charitable organization may be the ultimate beneficiary of the trust, a situation previously prohibited. In fact, we are no longer concerned when the will or trust names a charitable organization as a remote contingent remainder beneficiary in the event of a common family disaster. Naming a charity in the event of a family disaster no longer makes the trust a Non-Designated Beneficiary.

The final category of eligible Designated Beneficiaries is the beneficiary who is not more than 10 years younger than the account owner at the time of his death. In that case, the not more than 10 years younger beneficiary will be able to stretch out the annual distributions over the beneficiary's life expectancy. If the account owner was close to his Required Beginning Date, the chances are good that even a Non-Designated Beneficiary will have more than five years within which to withdraw the account.

It is important to ensure when possible that the Beneficiary is not classified as a Non-DB and required to make withdrawals over the longer of the owner's remaining life expectancy or five years. Non-DB status is actually a default that occurs when one fails to name a beneficiary at all, or where a beneficiary designation violates the rules discussed above. Non-DB status may be avoided by completing the custodian's own beneficiary designation form. Only by completing the custodian's form will the beneficiary be considered a "Designated Beneficiary." Naming children in your will as beneficiaries of all assets will not make those children Designated Beneficiaries of the retirement accounts. Therefore, we cannot stress strongly enough how imperative it is to name the beneficiary on the plan custodian's own beneficiary designation form and to deliver that form to the custodian. While the default beneficiary provisions on a retirement account may result in, for example, one's children being the beneficiaries, that default provisions does not make them Designated Beneficiaries. It is important, therefore, to periodically review beneficiary designations to be sure they reflect the desired beneficiaries and that the current plan custodian, whether a bank, a brokerage house or an employer, has the form on file.

While SECURE 2.0 is generally not as favorable as prior law to an account owner's adult children and other non-spousal beneficiaries, it does recognize and clarify the rules in effect when a trust (rather than an individual) is named as beneficiary of a retirement account, and for that guidance we should grateful.

# LINDABURY

McCormick, Estabrook & Cooper, P.C.

Attorneys at Law

New Jersey | New York | Pennsylvania

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