

New Retirement Law Changes Special Needs Planning

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Just before the end of 2019, Congress passed and the President signed a spending bill that includes significant changes to retirement savings accounts. Known as the Setting Every Community Up for Retirement Enhancement (SECURE) Act, this legislation changes rules around retirement plans in several key ways. Families with special needs members should pay close attention, as these changes will have an impact on their estate planning.



Stretch IRAS

The biggest change eliminates “stretch” IRAs in most cases. To understand the change’s importance, a little background is needed. IRAs are personal savings plans that allow you to set aside money for retirement and get a tax deduction for doing so. Earnings in a traditional IRA generally are not taxed until distributed to you. Any amount remaining in an IRA upon death can be paid to a beneficiary or beneficiaries, but the beneficiary is required to take a certain amount of money out of the account each year and pay taxes on it, called “required minimum distributions.”

Under the previous law, if you named anyone other than a spouse as the beneficiary of your IRA, the beneficiary could choose to take distributions over his or her lifetime and pass any remaining funds onto future generations (this was called the “stretch” option). The required minimum distributions were calculated based on the beneficiary’s life expectancy, so the younger the beneficiary, the smaller the annual distributions and the longer the inherited account money could be stretched. This allowed the money remaining in the account to grow tax-deferred over the course of the beneficiary’s life and to be passed on to his own heirs.

The SECURE Act requires most beneficiaries of an IRA to withdraw all the money—and pay the applicable income taxes—from the IRA within 10 years of the IRA holder’s death. In many cases, these withdrawals will take place during the beneficiary’s highest tax years, meaning that the elimination of the stretch IRA is effectively a tax increase on many Americans. This provision applies to those who inherit IRAs starting on January 1, 2020.

An Exception for Beneficiaries with Special Needs

The SECURE Act makes exceptions for IRA beneficiaries who are considered disabled according to the IRS. These individuals can receive the funds in the form of required minimum distributions based on their life expectancy rather than within 10 years. Also excluded from the 10-year rule are beneficiaries who are considered chronically ill or who are less than 10 years younger than the account owner.

But what happens if an IRA owner wants to designate as the beneficiary a person with a disability who is also the beneficiary of a special needs trust (SNT)? The new law states that the IRA owner can designate an SNT as the beneficiary, and the trustee can use the required minimum distributions to pay for the care and support of the person with special needs. The way to set this up is through what’s known as a “see-through” trust.

See-Through Trusts

On the IRA owner’s death, all the remaining money in the IRA goes into this trust and is distributed by the trustee according to certain structures and rules. The deferred taxes are due when the money is withdrawn from the trust in the form of required minimum distributions. If the beneficiary is a person with special needs (and certified as such by the IRS at the time of the IRA account owner’s death), distributions would be paid out over the beneficiary’s life (rather than within 10 years per the new rules in the SECURE Act).

Note that there are two types of see-through trusts: a conduit trust, in which the money is distributed to the primary beneficiary immediately, and an accumulation trust, in which the money is distributed over time. Both are irrevocable trusts, and both must be permissible under applicable state laws. Accumulation trusts work well for special needs beneficiaries because they can also receive government benefits for their care and support.

Other Beneficiaries Who Do Not Have Disabilities

Planning gets even more complicated if there are multiple IRA beneficiaries (siblings and grandchildren, for example). The trust will only be exempt from the 10-year rule if the individual with special needs is the only beneficiary of the trust during her life. If the trust also permits distributions to a spouse or children, it won't qualify and the IRA will have to be completely withdrawn within 10 years. The best solution may be to establish a see-through accumulation trust for the special needs relative, and set up a separate trust for other heirs.

In light of the new rules, consult with your special needs planner to review the language in your special needs trust (if you have one). You want to be sure that your retirement assets will be distributed in a way that best protects the money you have set aside for your loved ones.

For more on the SECURE Act, click here (<https://www.elderlawanswers.com/new-law-set-to-make-big-changes-to-retirement-plans-17502>).

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