Hoogendoorn & Talbot LLP

CLIENT ALERT:

THE SECURE ACT AND THE NEW ILLINOIS TRUST CODE

In late December, Congress passed the SECURE Act which includes significant changes to retirement plan rules for contributions and withdrawals. Last summer, Illinois passed the new Illinois Trust Code with sweeping changes to Illinois trust law. Both of these laws took effect January 1, 2020.

This alert is intended to help you understand the relevant changes, how they may affect your existing estate plan, and whether modifications to your plan are necessary.

Although the details of each act are important, the key points of each change are as follows:

SECURE ACT: How the new rules will affect individual retirement account owners and beneficiaries will depend on each client's particular circumstances. If your retirement account balances will result in less than $200,000 or so passing to each of your beneficiaries, the tax impact of this change will not be significant and revising your estate plan for this reason alone may not be necessary. On the other hand, if you have significant retirement account balances resulting in greater amounts passing to a beneficiary, and you have concerns about your beneficiary receiving the retirement account outright within 10 years of your death, you should call us so that we may review your plan and discuss alternative planning options.

ILLINOIS TRUST CODE: If your estate plan creates a trust fund for your spouse and/or children, new notice and accounting requirements may be more intrusive than you desire. The trustee of a trust fund for your spouse may have to provide an annual accounting showing trust assets, income, and expenditures not just to your spouse, but also to children who would receive the trust property upon your spouse's death. If your spouse is trustee, this means that your children would be able to look over your spouse's spending and investment decisions. This same rule may now apply to a fund for a child of yours where the trustee would have to account not just to the child, but also to the child's children. If these accounting rules are a concern for you, please contact us.

Read further for more information on both new laws.

THE SECURE ACT

The SECURE Act impacts both retirement plan owners as well as their beneficiaries at death. The law has changed so dramatically that many clients will need to revise their estate plans.

Highlights of Changes for Account Owners:

Working Persons Can Continue to Contribute to Retirement Accounts After Age 70 ½. The SECURE Act eliminates the prohibition on tax deductible contributions to traditional IRAs by individuals 70½ and older who continue working and have earned income. Americans are living longer and working beyond the traditional retirement age. Now they can continue saving for retirement so long as they are working and earning.

Age for required minimum distributions raised to 72.

Age for Required Minimum Distributions Raised to 72. Americans not only have more time to save, but they may wait longer before having to withdraw from their retirement accounts. The new law increases the age for taking required minimum distributions (RMDs) from 401(k) and IRA accounts from 70½ to 72. (Note that the new law still allows individuals to make "qualified charitable distributions" from IRA accounts after attaining age 70½, even if the individual is not yet required to take RMDs until after age 72.)

For individuals born **on or after July 1, 1949**, they must begin taking RMDs as of April 1 of the year following the year in which they reach age 72. Individuals born **on or before June 30, 1949** are governed by the old rules (meaning they attained age 70½ on or before December 31, 2019). They had to begin taking RMDs as of April 1 of the year following the year in which they reach age 70½.

Highlights of Changes for Beneficiaries:

Beneficiaries of IRAs and other retirement accounts (collectively "retirement accounts") received from decedents who died on or before December 31, 2019 will generally continue to be governed by the old rules. This means that a beneficiary's payout period in many cases may be stretched out over the beneficiary's life expectancy (known as a "stretch IRA"). Retirement accounts received from decedents who die after December 31, 2019 will be subject to the new SECURE Act rules described below, which dramatically change the payout periods for inherited traditional and Roth IRA accounts and 401(k)s.

Under the new rules, most beneficiaries will need to withdraw an inherited IRA within 10 years of the account owners death.

Spouse as Beneficiary. The SECURE Act does not significantly change the payout provisions for a spouse as a beneficiary or the provisions for spousal IRA rollovers. A spouse named as beneficiary continues to have the option to create a rollover IRA and to take RMDs over the spouse's life expectancy. However, the spouse now may defer taking RMDs until age 72.

"Stretch" Payouts Eliminated for Most Non-Spouse Designated Beneficiaries. Subject to a few limited exceptions, a non-spouse beneficiary, regardless of age, now is required to withdraw an inherited retirement account (including a Roth IRA) within 10 years of the original account owner's death. There are no RMDs, so the beneficiary may choose to withdraw some or all of the account balance at any time during the 10-year period.

Certain Beneficiaries May Still Receive Stretch Payouts. Beneficiaries who are exempt from the new 10-year payout rule are called "eligible designated beneficiaries," and payouts to them in most cases may continue to be made based on their life expectancy as it was under the old rules. These include a minor child of the account owner, a disabled or chronically ill person, and a person who is not more than ten years younger than the account owner.

Estate or No Named Beneficiary. If you have no named beneficiary, or if your estate is named as beneficiary, the payout period may be as few as 5 years.

THE SECURE ACT'S IMPACT ON IRA TRUST PLANNING

Under the new rules, the inherited retirement plan must be fully withdrawn (and taxed) within 10 years of the decedent's death. The account can be withdrawn at any time or times during that 10-year period. There is no RMD for an inherited retirement account.

Estate plans naming a trust as beneficiary of a retirement account may need to be revised.

The conduit trust concept included in many existing plans may continue to work, provided the client is comfortable with the beneficiary receiving the entire account outright in 10 years or less. When taking distributions from a retirement account and passing them out to the beneficiary, the trustee will want to consider the income tax consequences of the withdrawal and distribution. For example, the trustee might want to take a larger distribution from the retirement plan and pay it out to the beneficiary in a year in which the beneficiary is in a lower income tax bracket or has a charitable deduction that might offset the income tax on the distribution.

If you are not comfortable with this outright distribution, either because of concerns regarding a beneficiary's ability to manage money, the beneficiary's need for creditor protection due to a high risk profession or the need for protection from a divorcing spouse, your trust may be amended to add protection for these purposes. This involves giving the trustee the ability to retain some or all of the retirement account distributions in what is known as an "accumulation trust." However, if the retirement plan distribution is retained in trust rather than distributed directly to the beneficiary, the trust will be taxed on the distribution and the trust will pay income tax at the highest rate, which may be significantly higher than the rate the beneficiary would pay if the distribution was passed out to the beneficiary.

If your retirement account is a significant part of your estate and you are concerned that the beneficiary of your retirement account needs ongoing trust protection, please contact us.

THE ILLINOIS TRUST CODE

The new Illinois Trust Code is largely modeled on the Uniform Trust Code, which was created in an effort to standardize trust law among the fifty states. Illinois, like most states, did not adopt the Uniform Trust Code word for word. The new law is a combination of prior Illinois law and the uniform law provisions, in some cases modified to be more consistent with prior Illinois law.

Many of the provisions are intended to guide trustees with regard to modern trust law changes such as allowing trusts to be modified by a trustee through "decanting," allowing interested persons to modify a trust under certain circumstances using non-judicial agreements, allowing for trust governance where the distribution decisions and investment decisions of the trustee can be granted to separate persons (known as "directed trusts"), and providing better protections for trust beneficiaries.

Under the new law there are many new notice requirements which some may find burdensome or unnecessary. Many of these requirements can be waived in the trust instrument.

New Illinois Trust Code requires trustee to account to remainder beneficiaries annually unless this requirement is waived in the trust instrument.

For example, the new law requires annual accountings be delivered to all "qualified beneficiaries," which includes both the current beneficiary and certain potential remainder beneficiaries. Assume that you and your spouse have been married for many years and that, except for tax and creditor protection reasons, you would leave all of your assets to your spouse at your death. Your trust provides that all income and principal is to be held and used for your surviving spouse during his or her lifetime, and then, after both you and your spouse have died, trust property is to be distributed to or held for your children.

Under the new law, after your death, and while your spouse is living and acting as sole trustee, your spouse will be required to provide annual accountings of the trust assets and expenditures to your children. Essentially your children will be looking over your spouse's financial shoulder, and perhaps questioning your spouse's investment and/or distribution decisions.

This requirement does not apply if the spouse has a virtually unlimited power to change the beneficiaries at his or her death (known as a "power of appointment"). In the absence of such a power of appointment this requirement may be waived in the trust instrument. If you or your spouse is uncomfortable with the accounting requirement, please call us to discuss options for revising your estate plan.

Note that this accounting requirement also applies to trust funds created for children, more remote descendants, or other beneficiaries. In those cases, unless the child (or further descendant or beneficiary) has a broad power of appointment, he or she would be required to send accountings to his or her own children. Again, this requirement may be waived in the trust instrument.

If you wish to eliminate these notices and accounting rules where possible, please contact us.