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The Secure Act Makes Trust Planning for Retirement Benefits Less Secure

On December 20, 2019, the Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act) was signed into law. The SECURE Act, which became effective in part on January 1, 2020, includes several major changes related to retirement plans and retirement savings vehicles applicable to individuals and small businesses. One of the most significant changes made by the SECURE Act impacts wealth transfer and trust planning.

SECURE Act – The End of Stretch Planning

For “certain defined contribution plan” owners who die after January 1, 2020, the SECURE Act requires that most non-spouse beneficiaries of those accounts withdraw all the assets held in such accounts by the end of the 10th calendar year following the year of the account owner’s death. In other words, for most non-spouse beneficiaries, the SECURE Act eliminates both the requirement that annual minimum distributions be taken and “stretch” planning options for such inherited retirement plans. The SECURE Act applies only to “certain defined contribution plans,” which include IRAs, 401(k) plans, and 403(b) plans. The SECURE Act does not apply to defined benefit plans. For simplicity, the remainder of this article focuses on IRAs, but the SECURE Act similarly affects such other defined contribution plans.

Prior to the SECURE Act, a beneficiary of an inherited IRA generally could stretch out the tax-deferral advantages of the IRA by taking distributions over his or her life expectancy, as determined by IRS tables. When that technique is used to manage the required distributions from an IRA following the death of the IRA owner, the inherited IRA is commonly referred to as a “stretch IRA.” Under the SECURE Act, the only inherited IRA beneficiaries able to utilize the stretch IRA technique are the IRA owner’s surviving spouse and minor children (until they reach majority), disabled or chronically ill individuals, and beneficiaries who are less than 10 years younger

than the IRA owner. These individuals are known as “eligible designated beneficiaries” under the SECURE Act. For any other beneficiary, instead of being able to stretch the IRA distributions out over his or her life, he or she will need to withdraw all the funds in the IRA within 10 years of the IRA owner’s death.

Pre-SECURE Act – Common Trust Planning Options

Many individuals choose to pass their assets to their beneficiaries in trust to provide asset protection and asset management assistance, to minimize estate taxes over several generations, and to ensure that the inherited assets remain in the family. Under prior law, a trust designated as the beneficiary of an IRA usually would be designed to take advantage of the stretch technique, thereby allowing the inherited IRA to be paid to the trust over the trust beneficiary’s life expectancy. Such a trust typically would be structured either as a “conduit trust,” which requires the funds withdrawn from an IRA and paid to the trust to be distributed to the trust beneficiary almost immediately; or as an “accumulation trust,” which allows the withdrawn funds to be held in the trust or distributed to the beneficiary, according to the trust terms. Under the SECURE Act, both of these trust arrangements for non-spouse beneficiaries may lead to unintended tax consequences which likely will be contradictory to the IRA owner’s estate planning goals.

Post-SECURE Act – Necessary Review of Existing Trust Provisions

While trust planning for IRA assets under the SECURE Act may still be appropriate in many situations, the elimination of the stretch IRA and required minimum distributions for most non-spouse beneficiaries will require a review and reevaluation of estate plans in which a trust has been designated as the beneficiary of an IRA. In the case of a conduit trust for a beneficiary who is not a spouse or other eligible designated beneficiary, the time frame in which distributions must be made from an IRA to the trust will be compressed, resulting in larger distributions, which then may

generate a larger income tax liability to the beneficiary. Further, since the SECURE Act eliminates the requirement to take annual distributions from the IRA, the only *required* distribution is in the 10th year following the account owner's death. Depending on how the trust was drafted, it may not be possible for the trustee to withdraw funds from the IRA before year 10, thereby causing all the income tax associated with the inherited IRA to be due in one tax year. Additionally, under that scenario, the trust beneficiary will not receive any benefit from the IRA assets until year 10. Account owners need to review the terms of currently executed conduit trusts that are designated as beneficiaries of their IRAs to avoid such unintended income tax consequences, and may want to reconsider the use of conduit trusts altogether, given the newly required compressed distribution schedule applicable to certain trust beneficiaries.

In the case of an accumulation trust, the trust terms may be too restrictive to allow the trustee to avoid trapping all the IRA income in the trust by making distributions from the trust to the beneficiary. Most income earned by trusts is taxed at the highest marginal tax rate, so the trust beneficiary often will be subject to a lower tax rate than the trust. It is necessary to review the terms of currently executed accumulation trusts that are designated as beneficiaries of IRAs if planning to minimize income tax is a high priority for the account owner.

Trusts for Eligible Designated Beneficiaries – Consider Terms Closely

While eligible designated beneficiaries will still qualify for stretch planning options after the SECURE Act, current estate plans that implement trusts to hold inherited IRAs for the account owner's surviving spouse or other eligible designated beneficiaries should be reviewed. Previously executed trusts for spouses need to be reviewed to ensure that the trust will continue to be able to use the surviving spouse's life expectancy to dictate the withdrawal period for the inherited IRA. Further, many of those spousal trust arrangements provide that the beneficiaries who inherit the trust assets at the death of the surviving spouse also will receive the

assets in trust. Under the SECURE Act, the distribution period for those assets will “switch” from the surviving spouse’s life expectancy to a 10-year payout period for the secondary or contingent beneficiaries. In many cases, such existing trusts will need to be revised to give the trustee greater flexibility to engage in income tax planning for the IRA distributions.

Prior to the SECURE Act, many parents left their IRAs to trusts held for the benefit of their minor children. Previously, the child would have been able to stretch the IRA distributions over his or her life expectancy. Now if the child inherits an IRA in such a trust, the child will be able to stretch the IRA distributions using his or her life expectancy only until he or she reaches the age of majority, and then only if the trust contains certain provisions.

The SECURE Act is Effective – Moving Forward with Estate Planning

In sum, given the 10-year payout period now in place for most non-spouse beneficiaries, the decision whether to continue to utilize trusts (and the provisions in such trusts) to receive inherited IRA assets likely will turn on whether the asset protection features provided by the trust outweigh the potential increased income tax liability associated with taxing some or all of the distributions from the IRA at trust tax rates. If you have designated your trust as the beneficiary of your IRA (or other defined contribution plan), you should check with your estate planning attorney to see how the SECURE Act impacts distributions to your trust beneficiaries.

If you have any questions about restructuring your current plan or putting together a new plan for your retirement assets, please contact [Patricia D. Laub](#), [Audra E. Loomis](#), or any attorney in Frost Brown Todd’s Estates, Trusts and Wills Practice Group.

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