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Dear Clients and Friends,

We are pleased to announce
that it has been six successful months since
Venson ("Vince") R. Gill
joined the Rothman Law Group as an Associate.

Vince is a talented attorney who reflects our continued dedication to service, excellence and value.

We are writing to update you with respect to (i) recent developments regarding the income taxation of retirement assets and (ii) the new Illinois Trust Code.

I. **The SECURE Act**.

A. Background. At the end of 2019, several budget and spending bills were signed into law. Included in one of those bills was the SECURE Act ("Setting Every Community Up for Retirement Enhancement"), a retirement savings reform bill. The SECURE Act makes significant changes to the laws governing retirement benefits, such as pension plans, profit-sharing plans, 401(k) plans, 403(b) plans and individual retirement accounts ("IRAs") (generally referred to here as 'Retirement Plans').

The SECURE Act increases the opportunities to save for retirement. Most notably, it (i) provides tax incentives for small businesses to offer Retirement Plans, (ii) allows part-time workers to participate in employer Retirement Plans and (iii) defers the age at which participants in Retirement Plans must begin withdrawing from those plans from 70½ to 72.

To offset the decrease in tax revenue from these increased opportunities for participants to defer income taxes, the SECURE Act also eliminates a significant existing estate planning benefit of Retirement Plans: the ability of most non-spouse beneficiaries to "stretch" Retirement Plan distributions over their life expectancies.

B. Prior Law. Prior to the SECURE Act, the non-spouse beneficiary of a Retirement Plan would generally be required to begin taking distributions by December 31st of the year after the decedent's death. The beneficiary, however, could potentially "stretch" those distributions over the beneficiary's life expectancy, as determined at the death of the deceased participant. For example, a fifty-year-old beneficiary who received an inherited IRA from his or her parent would have been permitted to withdraw the assets from the inherited IRA over his or her thirty-five year life expectancy.

C. New Post-Death Distribution Requirements. Under the SECURE Act, with limited exceptions, the entire balance of a Retirement Plan must now be withdrawn by the non-spouse beneficiary or beneficiaries no later than December 31st of the year in which the tenth anniversary of the decedent's death occurs. For example, if a participant passes away June 30, 2020, a non-spouse beneficiary (with certain limited exceptions) designated under his or her Retirement Plan must withdraw the entire balance of the Retirement Plan by December 31, 2030. Since distributions from Retirement Plans, other than from a Roth IRA, are subject to income tax by the beneficiary at ordinary income tax rates, this acceleration of the withdrawal period is likely to accelerate the payment of income taxes, potentially at higher tax rates by the recipient beneficiary or beneficiaries.

As previously noted, the limited exceptions to this ten-year distribution deadline include the surviving spouse as a designated beneficiary. A surviving spouse may either (i) roll a deceased spouse's Retirement Plan into the surviving spouse's own IRA or (ii) elect to treat the deceased spouse's Retirement Plan as an inherited IRA. In either case, the surviving spouse has the ability to stretch the Retirement Plan distributions over his or her own life expectancy. This life expectancy may be recalculated annually to further extend the required distribution period for a surviving spouse. The SECURE Act, therefore, does not impact the treatment of a surviving spouse in any material way. **Consistent with our prior advice, we continue to recommend that so long as it is otherwise appropriate, a spouse be named as the primary beneficiary of any Retirement Plan.**

D. Impact on Estate Planning for Non-Spouse Beneficiaries. Before the SECURE Act, when Retirement Plan participants advised our office that they wished to name beneficiaries other than a surviving spouse, such as a child or children, we generally recommended the use of "conduit trusts" for the benefit of these individuals to be the Retirement Plan beneficiaries. A conduit trust, under the prior law, enabled a trust to be the beneficiary of a Retirement Plan while allowing the Retirement Plan distributions to be stretched over the trust beneficiary's life expectancy. In order to enjoy the ability to "stretch" the distributions, the conduit trusts were required to act as "conduits" for the beneficiaries and immediately distribute all Retirement Plan distributions outright to the respective trust beneficiaries.

Under the SECURE Act, however, a conduit trust will only permit the trust beneficiary to defer the distribution of the Retirement Plan for up to ten years. As a conduit, once any Retirement Plan distribution is made to the trust, the trust is required to distribute the entire amount of that distribution directly to the trust beneficiary. Therefore, even if the trustee of the conduit trust elects the maximum deferral period, the full balance of the Retirement Plan must be distributed by the end of that period to the beneficiary and the beneficiary will be responsible for the income tax on the full amount of the distribution. This result, as compared with an "accumulation trust" which is discussed in the following paragraph, could have the following detrimental results at the end of the ten year period: (i) the inclusion of the distributed Retirement Plan assets in the individual beneficiary's taxable estate, (ii) the availability of the Retirement Plan assets to the individual beneficiary's creditors, and (iii) the availability of the Retirement Plan assets to the individual beneficiary's spouse in the event of a divorce, if not effectively segregated.

E. Updated Recommendation for Non-Spouse Beneficiary Designations. Rather than risk these potential adverse consequences, we recommend that a different type of trust, an "accumulation trust", be named as the beneficiary of the Retirement Plan. Under this type of trust, the trustee will have discretion as to whether to distribute the amounts paid from the Retirement Plan to the beneficiary or to accumulate the funds in the trust for distribution to the trust beneficiary in the future under the terms of the trust or for future beneficiaries, if the current beneficiary is not in need of the trust funds.

An accumulation trust will still be subject to the ten-year distribution requirement, but because the distributed Retirement Plan assets can be allowed to *remain in trust*, the adverse results described above can be reduced or eliminated. The "trade-off", however, is that if the Retirement Plan distributions are retained in the trust, the income tax liability from the Retirement Plan distributions will remain at the trust level where the tax brackets can be higher than at the individual beneficiary level. The trustee, nevertheless, will have the flexibility of balancing the income tax consequences with the other anticipated benefits and deciding if and how much of any Retirement Plan distributions should be held and taxed at the trust level or distributed and taxed to the beneficiary.

Consistent with our prior advice, we continue to recommend that a non-spouse beneficiary receive his or her inherited Retirement Plan in a separate trust rather than outright. However, the type of trust we now recommend as a result of the passage of the SECURE Act is an "accumulation trust" in lieu of a "conduit trust". Our office has developed new trust language to achieve this result.

If you have any concerns regarding your Retirement Plans and how they will be treated under your current estate planning documents, please call us to discuss whether any updates should be considered.

II. **Illinois Trust Code.**

In 2019, the Illinois legislature enacted the Illinois Trust Code which is a codification of existing statutes and case law governing trusts in Illinois with some changes. The principal differences imposed by the new law include additional reporting requirements for trustees to beneficiaries during the administration of (i) irrevocable trusts established after December 31, 2019, and (ii) revocable trusts of which the grantor, or creator, of the trust has died after December 31, 2019.

These additional requirements include annual accountings and increased notice requirements for trust beneficiaries. Although these additional requirements are new, our firm has always considered these requirements to be “best practices”. We have developed updated language for our trust documents to address these changes in the law.

Once again, please contact us if you would like to discuss these changes or consider revisions to existing trust agreements.

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It is our hope that this brief discussion has provided you with information that will help you make informed and proactive estate planning decisions. As always, we are available to assist with any of the matters discussed in this letter and welcome all inquiries.

If you have any questions, or if we can be of any assistance, please do not hesitate to contact our office.

Kindest personal regards,

Rothman Law Group

Rothman Law Group is a Chicago-based law firm with an emphasis in estate planning, business planning and trust and estate administration. We combine the most sophisticated planning techniques with the ability to find practical solutions to individual problems. Our legal expertise coupled with strong relationship skills enables us to effectuate our clients’ goals while providing tax and other cost-saving strategies.