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IRA PLANNING IN THE NEW ERA:

Things Account Owners Should Be Aware of When Naming Beneficiaries

Passed and signed into law in last December, the **S**etting **E**very **C**ommunity **U**p for **R**etirement **E**nhancement Act of 2019, or **SECURE** Act, fundamentally changed how qualified account owners should approach naming beneficiaries.

What are qualified accounts?

Most of us have at least one type of qualified account, which provide us with certain tax advantages and allow us to proactively save for retirement. The most common account types are an IRA (traditional and Roth), a 401(k), or a 403(b). Some lesser-known account types include defined benefit, profit-sharing, and Keogh plans. It is estimated that more than $28 trillion of assets were held in retirement accounts at the end of first quarter of 2020.[1]

What changed?

For deaths occurring prior to 2020, named beneficiaries on a qualified account had the option of taking a minimum amount every year over their lifetime, known as required minimum distributions (RMDs), from the inherited funds. The SECURE Act removes the lifetime RMD option and replaces it with a universal 10-year time limit on payouts. There is an exception to this new regulation for a small group of beneficiaries – those who qualify as an Eligible Designated Beneficiary (EDB).

Who is an Eligible Designated Beneficiary?

An eligible designated beneficiary is anyone in the following categories:

- surviving spouse of the deceased account owner
- minor child of the deceased account owner (***Note:*** *when age of majority is reached, the child is no longer an EDB and the 10-year rule applies)*
- beneficiary who is no more than ten years younger than the deceased account owner
- chronically-ill individual

[1] https://www.pionline.com/retirement-plans/ici-retirement-assets-fall-12-first-quarter

Eligible designated beneficiaries have the freedom to take annual RMDs over their respective life expectancy, a strategy known as "stretching an IRA." In other words, the changes in the SECURE Act have no effect on them. While a surviving spouse will continue to have the option of combining a deceased spouse's retirement assets into her own IRA, all other beneficiaries must set up what is called an Inherited IRA and roll his/her portion into it before they are able to access the funds.

For simplified flowcharts and illustrations, head to the Toolbox on our website.

Why is this significant?

As you can see, non-eligible beneficiaries *must* withdraw all of the inherited assets within ten years after the death of the original owner. Without guidance from a knowledgeable advisor, a beneficiary may be tempted to cash out everything at once. It is not hard to play out multiple scenarios in our head of what they might do with the money.

"We must adapt to changes by understanding how these changes may affect our decisions and their outcomes."

Why should I care?

You may wonder why you would care about this since you will not be the one dealing with this. Perhaps you think that everything will go to your spouse or children, and they are more than capable of taking care of themselves.

First of all, if you care about your family and loved ones, this will matter. Family dynamics should be navigated with care. One of the most common (and consequential) areas of confusion we see in our practice is the ***per capita*** versus ***per stirpes*** designation on a beneficiary form. Under the ***per capita*** arrangement, in the event a beneficiary predeceases you and proper changes have not been made, his or her portion of the IRA would be evenly split between the other living beneficiaries. *Per capita* is even the default option on many financial institutions' forms. If your desire is to have the child(ren) of the predeceased beneficiary inherit the funds, then ***per stirpes*** should be explicitly indicated. By clarifying your desires, you can reduce or eliminate confusion or even legal contests by beneficiaries.

Additionally, retirement assets may constitute a big, if not the biggest, slice of your net worth. It is not uncommon to have amassed hundreds of thousands or even millions in a retirement account. It would be a shame to see beneficiaries squander it or pay an unnecessary price for mistakes that can be avoided. Most distributions from qualified accounts are fully taxable, except for those from a Roth IRA or Roth 401(k). If taxes are not deducted or set aside at the time of distribution, some people may find it hard to come up with the additional funds on April 15. Some quick tax planning or just knowing your household income situation can alleviate this problem.

Lastly, certain controls or "guardrails" can be placed on inherited assets with well-thought-out planning. For example, if one of the beneficiaries requires extra care due to a disability, directly inheriting retirement assets will usually lead to disqualification for public assistance. A special needs trust, in this case, should be drafted and named as beneficiary instead of that individual.

When using a trust to inherit qualified assets, you must follow specific IRS rules and pay attention to the distribution clause since RMD is no longer required. Certain flexibility and discretion should be included so the trust will not have to make a lump-sum distribution in the tenth year, potentially causing a massive tax hit.

As the saying goes, "Nothing stays the same forever." We must adapt to changes by understanding how these changes may affect our decisions and their outcomes. As planners, we are trained to map out possible outcomes and to minimize unpleasant surprises. Is it time to take another look at your beneficiaries? When it comes to your retirement assets, let us help you make informed decisions!