

Estate Planning Update: How the SECURE Act Affects IRA Beneficiaries

In December 2019, Congress passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which is changing retirement and estate planning for many. One major provision of the law affects those who inherit individual retirement accounts (IRAs). So, whether you might be inheriting an IRA or are planning on leaving one to your heirs, you should understand how the SECURE Act has changed the rules for beneficiaries. The IRA strategies discussed below could help enable a sound financial plan for a rewarding retirement—for both you and your heirs.

What's Different for IRA Beneficiaries?

The SECURE Act changes the time frame allowed for withdrawals from an inherited IRA. As you probably know, owners of a retirement account (other than original owners of a Roth IRA) generally must withdraw a minimum amount of money every year after they reach a certain age. These withdrawals are called required minimum distributions (RMDs).

Prior to the act, individual beneficiaries were entitled to take the RMDs from an inherited retirement account over the course of their life expectancy. By choosing to stretch their RMDs over time, they could benefit from tax deferral on any growth in the account. This situation has changed. Now, per the SECURE Act, many individual beneficiaries must completely withdraw the funds in an inherited retirement account within 10 years of the original owner's death.

Exceptions to this rule include account owners who are:

- A beneficiary who inherited an IRA from someone who died before January 1, 2020
- The surviving spouse of the IRA owner
- A child of the original decedent under the age of majority (Once the child reaches maturity, however, the 10-year rule applies.)
- A disabled or chronically ill individual
- An individual who is not more than 10 years younger than the IRA owner

As you can see, for many beneficiaries, the new 10-year withdrawal rule could result in substantially less tax-deferred growth, as well as more taxes due on withdrawal. Fortunately, there are steps you can take to help mitigate the tax burden on these IRA beneficiaries.

IRA Strategies to Consider

To help avoid any negative consequences of the 10-year withdrawal rule, the following strategies may be useful.

Converting to a Roth IRA. Although inherited Roth IRAs are subject to the new rule, distributions remain tax free. With tax rates at historic lows, you might want to consider a Roth conversion. Converting now would mean your beneficiaries (who may be in a higher tax bracket) could potentially avoid being heavily taxed on distributions.

Refusing to accept the IRA. You can refuse or disclaim inherited assets without tax implications. A qualified disclaimer must be in writing and submitted within nine months of the IRA owner's death. In addition, the beneficiary must not have received or exercised control over the IRA, and the IRA must pass to someone other than the person who refused it.

This strategy may work well for a surviving spouse who doesn't need the funds in the IRA. If the IRA passes to other beneficiaries (such as children), they would avoid a larger share of assets being distributed over a single 10-year period. In this case, one 10-year period would begin upon the death of the IRA's original owner and a second 10-year period would begin for the remaining balance of the account upon the death of the surviving spouse.

Naming a trust as beneficiary. With this option, the trustee can exercise control over when IRA distributions are made. If you named a trust as beneficiary of an IRA *before* the implementation of the SECURE Act, however, you should review your estate plan with an attorney. In some instances, trusts drafted before passage of the SECURE Act may now be obsolete, resulting in a distribution pattern that works against the original intent of the trust.

Naming a charitable remainder trust as beneficiary. One way to simulate the lifetime withdrawal rule enjoyed by IRA beneficiaries prior to the SECURE Act is naming a charitable remainder trust as beneficiary of an IRA. These trusts are structured so that as an IRA beneficiary, they would collect a stream of income from the IRA assets over a specified period. This type of strategy involves complex administrative and tax planning, so close coordination with legal and tax professionals is essential when implementing it.

Paying premiums on life insurance. Depending on your insurability, you may want to explore taking a withdrawal from the retirement account and use it to pay premiums on a life insurance policy. With this strategy, the beneficiaries of your policy would be set up to eventually receive a tax-free payout. This scenario might be more advantageous than leaving your retirement account to your heirs.

Making a qualified charitable distribution. If you're older than 70½, you're entitled to make a qualified charitable distribution (QCD). This is a tax-free gift of up to \$100,000 per year from an IRA, payable directly to a charity. QCDs may become more advantageous under the SECURE Act because IRAs might be considered a less attractive inherited asset due to the elimination of the lifetime withdrawal rule.

Revising the estate plan. Working with your attorney, you might want to revise your estate plan to take an asset-by-asset approach rather than assign assets to your heirs using a percentage. For example, you might earmark IRA assets to be distributed to minors or individuals in lower tax brackets and designate a larger proportion of nonretirement assets to those with higher incomes.

Helping Secure the Future

The changes adopted as part of the SECURE Act are complex, so it's important to work with a tax attorney to understand them. Given the new rules that affect many individuals who will inherit an IRA, you should consider a review of your estate plan and designated beneficiaries as a priority. Although many of the SECURE Act's changes benefit those saving for retirement, it's wise to be aware of all the options that can help you and your heirs better prepare for the future.

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