



Is It Time to Review Your IRA Estate Planning Strategies?

The Setting Every Community Up for Retirement Enhancement (SECURE) Act, which was passed in December 2019 as part of a larger federal spending package, included a provision that warrants special attention from those who own high-value IRAs. Specifically, the "stretch" IRA provision — which permitted non-spouse beneficiaries who inherited IRAs to spread distributions over their lifetimes — has been substantially restricted. IRA owners may want to revisit their estate planning strategies to help prevent their heirs from getting hit with higher-than-expected tax bills.

The old "stretch" rules

Under the old rules, a non-spouse beneficiary who inherited IRA assets was required to begin minimum distributions within a certain time frame. Annual distributions could be calculated based on the beneficiary's life expectancy. This ability to spread out taxable distributions over a lifetime helped minimize the annual tax burden on the beneficiary. In the past, individuals could use this stretch IRA strategy to allow large IRAs to continue benefiting from potential tax-deferred growth for possibly decades.

Example: Consider the hypothetical case of Margaret, a single, 52-year-old banking executive who inherited a million-dollar IRA from her 85-year-old father. Margaret had to begin taking required minimum distributions (RMDs) from her father's IRA by December 31 of the year following her father's death. She was able to base the annual distribution amount on her life expectancy of 32.3 years. Since she didn't really need the money, she took only the minimum amount required each year, allowing the account to continue growing. Upon Margaret's death at age 70, the remaining assets passed to her 40-year-old son, who then continued taking distributions over the remaining 13.3 years of Margaret's life expectancy. The account was able to continue growing for many years.

The new rules

As of January 2020, the rules for inherited IRAs changed dramatically for most nonspouse beneficiaries.¹ Now they generally are required to liquidate the account within 10 years of the account owner's death. This shorter distribution period could result in unanticipated and potentially large tax bills for high-value inherited IRAs.

***Example:** Under the new rules, Margaret would have to empty the account, in whatever amounts she chooses, within 10 years. Since she stands to earn her highest-ever salaries during that time frame, the distributions could push her into the highest tax bracket at both the federal and state levels. Because the account funds would be depleted after 10 years, they would not eventually pass to her son, and her tax obligations in the decade leading up to her retirement would be much higher than she anticipated.*

Notable exceptions

The new rule specifically affects most non-spouse designated beneficiaries who are more than 10 years younger than the original account owner. However, key exceptions apply to those who are known as "eligible designated beneficiaries" — a spouse or minor child of the account owner; those who are not more than 10 years younger than the account owner (such as a close-in-age sibling or other relative); and disabled and chronically ill individuals, as defined by the IRS. The 10-year distribution rule will also apply once a child beneficiary reaches the age of majority and when a successor beneficiary inherits account funds from an initial eligible designated beneficiary.

A word about trusts

In the past, individuals with high-value IRAs have often used what's known as conduit — or "pass-through" — trusts to manage the distribution of inherited IRA assets. The trusts helped protect the assets from creditors and helped ensure that beneficiaries didn't spend down their inheritances too quickly. However, conduit trusts are now subject to the same 10-year liquidation requirements, so the new rules may render null and void some of the original reasons the trusts were established.

What can IRA account owners do?

IRA account owners should review their beneficiary designations with their financial or tax professional and consider how the new rules may affect inheritances and taxes. Any strategies that include trusts as beneficiaries should be considered especially carefully.

Other strategies account owners may want to consider include converting traditional IRAs to Roths; bringing life insurance, charitable remainder trusts, or accumulation trusts into the mix; and planning for qualified charitable distributions.

¹ For account owners who died prior to December 31, 2019, the old rules apply to the initial beneficiary only (i.e., successor beneficiaries will be subject to the 10-year rule).

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