



# Retirement Account Strategies and Tips

The SECURE Act shortened the distribution period for designated beneficiaries of retirement accounts. For successor beneficiaries the distribution period is less than 10 years.

The required minimum distribution (RMD) regulations allowed a designated beneficiary to distribute an inherited IRA over his life expectancy if the IRA owner died before 2020. This meant being able to accumulate tax-deferred growth on non-RMD amounts for many years for young designated beneficiaries. If that designated beneficiary died before 2020, his successor beneficiary could continue taking distributions over what remained of the designated beneficiary's life expectancy. The Setting Every Community Up for Retirement Enhancement (SECURE) Act – which became law in December 2019, severely limited these benefits for IRAs inherited after 2019.

## Background– Back to Basics

To begin to understand the distribution rules that apply to beneficiaries, one must first understand some basic beneficiary related definitions:

**Designated Beneficiary:** An individual who inherits an IRA and is not limited by any extenuating circumstances that would cause him to lose his designated beneficiary status. This definition applied before the SECURE Act and continues to apply under the SECURE Act.

**Eligible Designated Beneficiary:** A designated beneficiary who is:

- A. the surviving spouse of the IRA owner
- B. a child of the IRA owner who has not reached the age of majority, as defined under state law. Once the child reaches the age of majority, that child becomes a regular designated beneficiary and has 10 years (after reaching the age of majority) to distribute the inherited IRA
- C. disabled- which generally means meeting the social security administration's definition of disability
- D. chronically ill - subject to meeting certain specific requirements, or
- E. an individual not described in any previous categories (A to D) who is not more than 10 years younger than the IRA owner.

This definition is new and was introduced under the SECURE Act effective for years after 2019.

**Successor Beneficiary:** A beneficiary that inherits an IRA from a designated beneficiary or an eligible designated beneficiary.

## Distribution Options for Designated Beneficiaries

If a designated beneficiary inherited an IRA from an owner who died before 2020 and the terms of the IRA agreement did not dictate otherwise, the designated beneficiary would be eligible to take distributions over his single life expectancy.

**Exception:** If the IRA owner died after RMDs were required to begin from the IRA, the beneficiary could take distributions over the longer of his life expectancy or the decedent's remaining life expectancy.

Whichever life expectancy applied to the designated beneficiary would continue to apply to his successor beneficiary after his death. **For example:** If John inherited an IRA at 30 years old, he would be eligible to distribute the IRA over his life expectancy period of 52.4 years, which would begin the following year when he reaches age 31. If John dies at age 32, his successor beneficiary would be eligible to continue taking distributions over John's remaining life expectancy of 51.4 years.

Under the SECURE Act, the distribution periods for designated beneficiaries and successor beneficiaries are now much shorter. Let's take a look at a case study:

	<b>IRA Owner– Mary</b>	<b>Original beneficiary (nonspouse) Dick– designated beneficiary</b>	<b>Successor beneficiary– Harry</b>
Date or year of birth	05/08/1950	1956	1964
Date or year of death	10/06/2017	2019	N/A

When Mary died, Dick- who reached age 62 the following year, was eligible to take distributions over his single life expectancy of 23.5 years beginning by December 31, 2018.

When Dick died in 2019, he had a remaining life expectancy of 22.5 years. His successor beneficiary, Harry, was eligible to continue taking distributions from the IRA over that remaining 22.5 years.

Harry's real age is never factored into the analysis because he is merely a successor beneficiary.

Assuming a rate of return of 5% and no more than RMDs were taken each year, the total distributions would have been \$1,234,549; a significant income to the beneficiary, which would be compounded if the IRA was a Roth, as no income tax would be due on the amount.

Now, let's change the date of the designated beneficiary's death to after 2019 to see how the SECURE Act affects the distributions.

	<b>IRA Owner– Mary</b>	<b>Original beneficiary (nonspouse) Dick– designated beneficiary</b>	<b>Successor beneficiary– Harry</b>
Date or year of birth	05/08/1950	1956	1964
Date or year of death	10/06/2017	2021	N/A

When Mary died, Dick was eligible to take distributions over his single life expectancy of 23.5 years, beginning by December 31, 2018.

When Dick died in 2021, Harry was subject to the new 10-year rule under the SECURE Act. Here, Harry's distributions are optional until December 31, 2031, at which time the entire balance must be distributed.

Assuming a rate of return of 5% and that no more than RMDs were taken each year, the total distributions would have been \$1,121,344- a difference of \$113,205 (\$1,234,549-\$1,121,344), which would have been even more significant if the designated beneficiary was younger.

### **The Exception for Eligible Designated Beneficiaries**

While the life expectancy option is no longer available to a designated beneficiary who inherits an IRA after 2019, it applies to an eligible designated beneficiary. When an eligible designated beneficiary dies, the successor beneficiary is then subject to the 10-year rule.

### **IRA Savvy Advisors Can Help to Ensure Accurate Application of the Rules**

With the changes made under the SECURE Act, interested parties must be even more vigilant when determining which distribution options apply to designated beneficiaries and successor beneficiaries. Failing to apply the rules accurately could result in beneficiaries taking less than their RMDs, and any RMD shortfall would be subject to an IRS assessed 50% excess penalty.

This is a high-level overview. Many more rules apply to inherited IRAs. These include the special rules that apply to spouse beneficiaries and other eligible designated beneficiaries. Working with an advisor who understands these rules can help to avoid mistakes.

### **Important Disclosure**

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