



NEW IRA **BENEFICIARY** **RULES**

Avoiding IRA Beneficiary Mistakes with the new IRA RMD Regulations

By Bruce Hosler EA, CFP®, CPWA®, AIF®, CEPA®



- *IRS Proposed SECURE Act RMD regulations, Released by IRS on February 23, 2022*
- *Retirement Plan payouts to Beneficiaries (For deaths AFTER 2019)*
- *This regulation will affect deaths in 2020 and afterward*

The IRS released 275 pages of changes in RMD (Required Minimum Distributions) in February of 2022. These are proposed regulations, but it is expected that most of them will be approved and become final regulations.

I have focused on sorting through all the regulations and providing the most important items in the regulations, how they may affect you, and MOST importantly, those areas where you have planning choices that can make a difference on the outcome that you and your family may experience. So, let's dig in.

Under the Secure Act, retirement plan beneficiaries have been divided into 3 classes. Depending on which class the beneficiary falls into will determine the post-death payouts after 2019.

- Non-Designated Beneficiary (NDB)
- Non-Eligible Designated Beneficiary (NEDB)
- Eligible Designated Beneficiary (EDB)

**Some Government Plans 403(b), 457(b) and (TSP) Thrift Savings Plans have been extended for 2 years until December 31, 2021*

Let's review each of these new classes of beneficiary designations:





Non-Designated Beneficiary (NDB)

These are beneficiaries that are not natural persons (non-people). Examples would include Charities, Estates, and non-qualifying trusts (i.e. Non-look through trusts)

Pay out rules for NDB's

The required beginning date (RBD) has become central in the payout rules for the new Secure Act RMD regulations. The RBD is generally April 1 in the year after the IRA owner turns 72. (The year after your 72nd birthday)

If the owner dies **BEFORE** their RBD, the account must be distributed in full by the end of the 5th year after death. Hence, the 5-year rule. There are not any annual RMD's during the 5-year period.

If the owner dies **AFTER** (or on) their RBD, then RMD's must be taken each year of the deceased IRA owners remaining single life expectancy. This has aptly been named the "ghost life rule" by Ed Slott.

Non-Eligible Designated Beneficiary (NEDB)

These beneficiaries are natural persons (people beneficiaries) that do not qualify as an EDB (Eligible Designated beneficiary).

Examples of NEDB would include grandchildren, older and adult children, and some look-through Trusts.

Payout rules for NEDB's

If the owner dies **BEFORE** the RBD, then the beneficiary will not have to take annual RMD's during the 10 years following the death of the owner. Known as the 10-year rule.

If the owner dies **AFTER OR ON**, the RBD then annual RMDs must be taken by the beneficiary for years 1-9. The calculations of RMDs was not clarified in the proposal.

By the end of the 10th year, the entire retirement account balance must be distributed in full in order to avoid the penalty.

ELIGIBLE DESIGNATED BENEFICIARY (EDB)

These beneficiaries receive special treatment in the SECURE Act. They are exempt from the 10-year rule. They can elect to receive the Pre-2020 Stretch IRA rules. If the account owner died before their RBD, the EDB is eligible to elect the 10-year rule treatment.

To qualify to be an EDB, the beneficiary must be a designated beneficiary.



There are 5 Classes of Eligible Designated Beneficiaries (EDB's)

1. Surviving Spouses.
2. Minor Children of the account owner (younger than 21 years old) – not grandchildren.
3. Disabled individuals – must qualify under the strict IRS rules.
4. Chronically ill individuals.
5. Individuals not more than 10 years younger than the IRA owner.

*Two other special groups also qualify for treatment as EDB's

- Designated beneficiaries who inherited BEFORE 2020. This would include qualifying trusts. These beneficiaries are grandfathered under the old pre-2020 Stretch IRA rules. They are NOT subject to the new 10-year rule.
- In certain scenarios, qualifying Look-thru trusts that are created for the sole benefit of the EDB's numbers 1-5 above. Consultation with an attorney is recommended.

Important Detail: The determination of a beneficiaries' status as a (NDB, NEDB, or EDB) is established on the owner's (or plan participant's) date of death. This status is established on the date of death and cannot be changed.

When an EDB dies, or no longer qualifies (Minor reaches age 21) the 10-year rule will then apply to them or will be applied to their designated beneficiaries. (For example, successor beneficiaries)

New ALAR rule. The "At least as rapidly" (ALAR) rule is a new rule introduced with these proposals. We are not absolutely sure how the IRS will interpret this new rule. Ed Slott believes that the rule will be applied as I outline below.

The rule applies when the retirement account owner dies AFTER or ON their RBD (Required Beginning Date) usually April 1st the year after you turn 73 years old. When someone dies after this date, and they are leaving the account to a noneligible designated beneficiary (That generally means any of your children).

THE PLANNING OPPORTUNITIES

What this means:

- Your adult children (non-eligible designated beneficiaries) will have to take RMD's starting the year after your death for 9 years based on their single life expectancy (make sure to use the right chart)
- The full balance of the IRA will have to be withdrawn before the end of the 10th year

The planning opportunities in the new IRS SECURE Act IRA RMD Proposed Regulations

Well, what does all this mean to you?

What should you do about all these new regulations?

What changes do you need to make in your Beneficiary, retirement distribution, and Estate planning?

That is what I want to address in this E-book. From here I will identify planning opportunities that you should be considering in light of these new regulations.

1. Your spouse is an EDB. Generally, you will want to name your spouse as your sole primary beneficiary. He or she will be able to take advantage of the Stretch IRA rules, or even move the IRA into their own name at your death and avoid the new rules pertaining to them as a beneficiary.

2. Other non-spouse EDB family members. If you have any other family members that may qualify as EDBs (individuals with Chronic illnesses, or Disabilities) you will want to consider how they may be able to benefit more than other family member when you name them as a designated beneficiary of your IRA, Roth, or other retirement accounts.

3. Name your Siblings as beneficiaries - EDBs. Those not more than 10-years younger (that means that your siblings) are excellent candidates to qualify as EDB's and receive the benefits of the stretch IRA. If you were going to leave some money from your estate to one or more of your siblings who are within 10 years of your age. Naming them is a great move. Allowing them to stretch out the RMD's. You can leave other assets to your heirs that may be more tax advantageous with a step-up in basis at your passing.



IRAs ARE NOW A LOUSY WEALTH TRANSFER TOOL

4. Split your IRA into separate IRA accounts and leave different accounts to different beneficiaries depending on their eligibility status. For example, if you want to leave some IRA funds to your sister, separate that amount into a separate IRA. She can stretch the RMDs, when your children may not qualify to do so. It is allowed to try and split the IRA after your death. But such planning is fraught with the potential for mistakes. You may not want to leave it to your beneficiaries to split the IRA after your death and accidentally screw up your wishes. If you split the IRA or Roth while you are alive, you avoid those types of mistakes altogether.

5. The Applicable Multi-Beneficiary Trust (AMBT): You may have set up a trust to help protect some of your beneficiaries who may be chronically ill or disabled and the benefits they may qualify for. It is better than setting up a trust with multiple beneficiaries. Instead, set up separate IRA accounts, and then a single trust for the benefit of a specific heir. By setting things up that way, you can ensure that you are in control of setting this up correctly while you are still living and can oversee the proper establishment of this level of estate and financial planning.

6. IRAs are now a lousy wealth transfer tool. The new regulations have removed the stretch IRA lifetime distribution option for most families. Your children will now have to start taking RMDs the year after you die. Then they will have to most likely (and wisely, I might add -try and take out 10% per year each year so that when the 10th year arrives, they do not create a huge tax time bomb when they must pull out the FULL remaining balance of your IRA or Retirement account. This destroys the extended tax deferral benefit by the stretch-IRA withdrawal strategies once offered. It has now become the worst way to leave your IRA to your heirs.

7. The HUGE Roth Advantage – The Roth IRA owner is ALWAYS assumed to have died before their RBD. None of us know when our time will come. One way that you can guarantee to leave your retirement accounts in the most favorable status for your living beneficiaries is to convert them to Roth IRA Accounts. The Roth IRA does not have an annual RMD requirement for the first ten years after you die- no matter when you die. With life expectancies increasing every year, there is a high likelihood that you will live past your RBD (age 72).



BENEFICIARY

CREATE YOUR IDEAL BENEFICIARY PLAN WHILE YOU ARE ALIVE

If you do, you will most likely force your children to pull out the IRA in the least favorable terms possible (The Government's plan) with the new regulations. By converting your IRA or other Retirement accounts to a Roth IRA during your lifetime, you can guarantee that your children will be able to leave the Roth growing Tax-free and not have to take any distributions from it for 10 years. In the 10th year, they will have to pull it all out – but the proceeds will be tax-free to them, and they will have had an additional potential 10 years of tax-free growth. What a fantastic gift to leave to your posterity. Remember that Roth conversions usually increase your taxable income in the year you convert, so consultation with a tax professional is always recommended.



8. Exchange your IRA for a more favorable wealth transfer tool. Some people don't trust our US government. They fear that the Roth IRA may eventually be taxed a 2nd time. Since the IRA is no longer a good wealth transfer tool, the time has come to consider another efficient wealth transfer tool-- the cash-value life insurance policy. I have historically favored the Roth IRA conversion and have generally recommended that in the past. But some of you want to leave a greater tax-free inheritance to your heirs. In some instances (subject to age and insurability), you can create a tax-free inheritance for your children. You should not take your IRA out all in one year. You should plan to strategically move funds from your IRA (with proper tax withholding from the IRA) to a life insurance retirement plan policy over a number of years so you are never pushed into a tax bracket that is too high. This strategy allows you to take advantage of the tax laws to leave your children a more significant tax-free inheritance without all the IRS regulations affecting IRA distributions.

9. Don't Forget. Grandchildren do not qualify as EBDs. Only minor children qualify. This is an important reminder. A minor child can qualify as an EBD and will not have annual RMDs until 10 years after the death of their parent when they will have to distribute the entire IRA. This treatment is not available to grandchildren. IRAs are no longer a good wealth transfer tool to help grandparents leave an inheritance to their grandchildren. A Roth IRA, on the other hand, is an excellent option for leaving funds from a grandparent to a grandchild.

Use the “10% per year strategy”

10. Create your ideal beneficiary plan while you are alive. After you die, it is too late. The determination of your Eligible Designated Beneficiary is on the day you die. It is too late for your heirs to make changes after you die. Their hands are tied. The die is cast, and whatever planning you have created is fixed. Make sure you consider your options and keep your beneficiary designation forms current with your wishes.

11. Make sure to use contingent and tertiary beneficiary designations. In many instances, IRA custodians will allow you to name contingent and tertiary beneficiaries. Let me illustrate how important this flexibility is. John died and has named Sally, his wife, as his primary beneficiary, Joseph, their son, as the contingent beneficiary, and Jessica, his granddaughter, as his tertiary beneficiary. After John's death, Sally, his wife, can elect to disclaim some or all of that IRA account. That means that Joseph, his son, can elect to receive the IRA as an inherited IRA and be the beneficiary, or he can also elect to disclaim. If Joseph disclaims like his mother, then Jessica, his daughter and the Granddaughter of John and Sally will now become the beneficiary of John's inherited IRA. This type of planning can provide great flexibility to the family. Combined with splitting IRA accounts during your lifetime, you can create some powerful wealth transfer techniques and flexible estate planning options for your family. Keep in mind that it is essential to coordinate with an attorney when exercising a disclaimer, as there are IRS deadlines for accomplishing a disclaimer in a tax-free manner.

12. If you fail to take an RMD, be sure to use the automatic IRS waivers for the 50% missed RMD penalty. If you miss taking an RMD in the year that an IRA owner passes away, you can qualify for an automatic waiver as long as the beneficiary takes the RMD by the beneficiary's tax filing deadline (including extensions).

13. Use the “10% per year strategy” for non-EDB beneficiaries subject to the 10-year rule to make sure they are not forced to take a huge IRA distribution in the 10th year. Beneficiaries of inherited IRAs that are non-EDBs are subject to the 10-year rule. They have to have emptied and recognize the income as taxable income by the end of the 10th year. In order to avoid having a huge amount of taxable income in the 10th year and perhaps having to pay an outrageous tax rate in that one year. Beneficiaries should consider taking distributions or RMDs that are closer to 10% more or less depending on their other taxable income in any given year to minimize the overall tax rate they will have to pay on the IRA over the 10-year period.



THESE REGULATIONS ARE PROPOSED TO BE EFFECTIVE FOR 2022 RMDs

14. If “Divorce protection” is a benefit you would like to provide your children, consider converting your IRA to a Roth IRA, and name an IRA Beneficiary Trust, (A See-through accumulation trust) as the beneficiary. Many IRA owners want to protect their children’s inheritance against divorce. They do not want the son-in-law or daughter-in-law whom they never liked, to be able to take one - half of their retirement fund from their child should a divorce occur. Without an IRA Beneficiary Trust, there is a possibility that a significant portion of an inherited IRA would be lost to the child’s spouse in a divorce. Name an IRA Beneficiary Trust to protect against a child’s potential future divorce. A Roth IRA can assure that your child will receive the ability to leave the Roth IRA growing for 10 years tax-free before they will have to distribute the inherited Roth IRA account to the IRA beneficiary Trust. Tax rates on trusts are very high on just a low amount of income. In 2024, the 37% tax bracket starts at just \$ 15,201+ for a trust. To ensure that this type of planning will work the best for your child, you will need to convert your IRA to a Roth IRA and set up an IRA beneficiary Trust. This can potentially provide asset protection for them, including protecting their inheritance from an unexpected divorce. We can help you work with the right attorney to set up an IRA Beneficiary Trust.

15. These regulations are proposed to be effective for 2022 RMDs. Please do not make the mistake of disregarding the regulations merely because they are proposed regulations. It is possible that these regulations are effective for tax year 2022. Be sure to plan accordingly. Waivers were provided for tax years 2021 to 2023. Going forward, we expect the IRS will start enforcing the RMD rules.

16. Multiple beneficiaries and separate accounting are still allowed as long as the accounts are split by December 31st of the year following the death of the IRA account owner. It may be too late if you have not created separate IRA accounts, as I recommended above. Once the IRA owner dies with multiple IRA beneficiaries, you have until December 31 of the year following the year of death to set up separate IRA accounts for each IRA beneficiary. Make sure to use a trustee-to-trustee transfer for each of the transfers to avoid complications with the “once-per-year rule.”

17. Pre-Secure Act beneficiaries (IRA owner who dies before 2020) needs to re-set their stretch IRA life expectancy factor. The IRS has released a new Single Life Expectancy table for 2022. IRA beneficiaries with inherited IRAs before 2020 will need to recalculate their RMD for 2022 (taken in 2023) and, going forward, use the new Single Life expectancy tables.



Entire balance of Roth IRA must be distributed to beneficiaries in the 10th year

18. Make sure you use the correct Uniform Lifetime Table in 2022 (either old or new). The new uniform lifetime table is to be used for RMDs taken for 2022. These RMDs will typically be taken in 2023. **This table is NOT to be used for 2021 RMDs taken in 2022.**

19. The new 2022 Uniform Lifetime table is to be used by the following:

1. IRA & Retirement account owners 72 and older for RMDs beginning in 2022.
2. Beneficiaries will never use this Uniform Lifetime Table to compute their RMDs on inherited IRAs.

20. The new 2022 Single Life Expectancy Table is to be used for Inherited IRAs.

1. Designated Beneficiaries (DBs) who inherited BEFORE 2020
2. Designated Beneficiaries who inherit in 2020 or later and the account Owner dies AFTER or on their RBD – Use it for years 1-9 of the 10-year period.
3. Eligible Designated Beneficiaries (EDBs)
4. Non-Designated Beneficiaries - when the account owner dies AFTER or on his/her RBD for the “ghost life” RMDs.

21. Roth IRA Beneficiaries that are (NEDBs: Non-Eligible Designated Beneficiaries) This would include your children who do not have a chronic illness or disability; it has been interpreted that they don't have to take any RMDs for years 1 through 9 after your death. But then you must distribute your Roth IRA's entire balance in the 10th year.



700 S. Montezuma St. | Prescott, AZ 86303 | Tel. (928) 778-7666 | Fax (928) 778-0499
7400 E. Pinnacle Peak Rd., Suite #100 | Scottsdale, AZ 85255 | Tel. (480) 994-7342 | Fax (928) 778-0499

Securities and Advisory Services offered through Commonwealth Financial Network® Member FINRA/SIPC, a Registered Investment Adviser. Tax and accounting services offered by Hosler Wealth Management, LLC are separate and unrelated to Commonwealth. Commonwealth does not provide tax or legal advice. Fixed insurance products and services offered through CES Insurance Agency.

Any tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding Federal or State tax penalties or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein. Furthermore, any advice, calculation or opinion given is based on information provided. Any information received that is incomplete or inaccurate may affect the advice given.