The SECURE ACT demands new beneficiary planning for your IRA and Roth IRA!

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

We have lost the Stretch IRA.

Jim had worked and saved for more than 30 years. His 401K had grown to more than 2 million dollars. He and his wife Sarah had wanted to leave a large IRA inheritance to their daughter Jessica, and their three grandchildren. They imagined their daughter Jessica stretching out the IRA RMD (Required Minimum Distribution) payments the rest of her life with surplus left to help provide for their grandchildren.

When Jessica experienced an unexpected nasty divorce, they became acutely aware how important it was to protect the nest egg they had saved to provide for their daughter and grandchildren.

They had an IRA Beneficiary trust prepared to provide future asset protection for Jessica. It would provide asset protection for Jessica, and protection from a future divorce, should she remarry as she was still fairly young. This beneficiary planning was sound and well thought out. Jim and Sarah had all their ducks in a row as far as it came to their IRA beneficiary planning.

Then the Secure Act was enacted in December 2019. All of their IRA Estate planning will no longer work the way they had hoped.

The Secure Act takes away "Stretch IRA" planning as we knew it.

The Secure Act has done away with the stretch IRA. The Secure Act's new rules require that beneficiaries completely distribute (and pay taxes on) the proceeds of the IRA within 10 years. These new rules have made all prior stretch IRA planning obsolete.

Prior to the Secure Act, IRA owners could leave their IRA to their loved ones and it could be "stretched out" (that is, the RMD required minimum distributions were based on the life expectancy of the beneficiary), usually only requiring 2% or 3% to be paid out each year. You can imagine if the IRA account could produce 6% in growth and income, and only 2% was required to be distributed, that the IRA account would have a reasonable likelihood of being able to provide income to the IRA beneficiary for the remainder of their life, maybe 30 years or more.

That is all gone now.

The New "10-year Rule"

The Secure Act has implemented a new "10-year rule". Beneficiaries of traditional IRA's, 401K's, and Roth IRA accounts will have to remove all of the funds inside of the retirement account by December 31st of the 10th year following the death of the IRA owner.

As you can imagine, this rule complicates the ability of IRA owners to leave a legacy to their loved ones. Additionally, the "10-year rule" creates all kinds of new tax complications for the beneficiaries of IRA and 401K accounts.

During the 10-year period there are no RMD withdrawal requirements. The beneficiary may take all of the funds out the very first day. Or, they may wait the entire 10 years, and then be required to withdraw the IRA funds all at once at the end of the 10-year period. I am sure you can picture in your mind the size of the tax bill that would be created if your beneficiary pulled out one-million-dollars from an IRA account in one year. There goes 40% of the IRA down the drain to Federal and State Taxes.

The 10-year rule creates IRA beneficiary planning complexities that we have never encountered before. New issues arise for IRA owners, for example: They may want to provide control over the distribution of the IRA after they pass. It also provides concern that their loved ones that may not be receiving the proper advice on how to take advantage of all of these complex new rules and pay the least amount of taxes possible.

The exceptions to the new 10-year rule “Eligible Designated Beneficiaries”.

There are exceptions to the 10-year rule that you will want to be aware of. They include:

- Surviving spouse
- A minor child*
- A disabled individual
- Chronically ill persons
- A beneficiary who is not more than 10 years younger than the decedent

*Note: Applicable only until the minor reaches age of majority.

These exceptions to the 10-year rule potentially allow these “Eligible Designated Beneficiaries” to use the stretch IRA benefits. These exceptions allow for continued use of the old stretch IRA rules for these designated beneficiaries, while all other beneficiaries must abide by the new 10-year rule.

If you are planning to leave your IRA to beneficiaries, some of whom qualify for the exception to the 10-year rule, and some who may not, such legacy planning will assure Secure Act complexities in your IRA beneficiary planning.

We have found the cleanest way too clearly protect the benefits of those that qualify for the exception, is to separate your IRA into separate IRA accounts. Thereby, leaving a specific IRA account to a specific beneficiary.

By separating out your IRA account in two or more separate IRA accounts, you will be able to clearly establish and protect benefits that are specific to each beneficiary without confusion or complexity.

Tax planning issues if higher tax rates are in our future.

Many American taxpayers are concerned about our national debt. As it grows higher, they are fearful that we will have to pay these debts down in the future. The Medicare trust fund runs out of money in 2026. Those funds in the future will have to be taken from the coffers of the American tax system.

For these reasons, many professionals and illuminated thought leaders in the area of tax, and tax policies, feel that there is a high likelihood that we will be facing much higher tax rates in the future.

The tax ramifications of IRA beneficiary planning in a higher tax rate environment take on a whole new significance. The consequences of making a mistake becomes much more expensive for your beneficiaries if the tax rates are twice as high as they are currently.

IRA owners with large IRA balances would be wise to consider their options and to take the time to plan how they can begin “Moving to tax-free”.

We recommend our clients use “the tax bracket strategy” to begin to strategically move their IRA funds to tax-free Roth IRA accounts. The difference this kind of planning can make for your IRA beneficiaries’ overtime can be dramatic.

You will need to create a tax plan each year, looking at your marginal and effective tax bracket for the year. Then you will need to plan for how much of your IRA you can convert to a Roth IRA each year, without bumping your “Effective tax bracket” into a tax bracket that is too high, while at the same time trying to take advantage of the current lower tax rates provided by the Tax cuts and Jobs Act. The Tax Cuts and Jobs Act sunsets the end of 2025, so you have the years between now and then to try and convert as much of your IRA to a Roth IRA as you can.

Planning for your IRA & 401K beneficiaries is dramatically different from how you will want to plan for your Roth IRA beneficiaries.

Please imagine with me that you have an IRA account worth one million dollars. You also have a Roth IRA account worth one million dollars. Now consider, that you pass-away and leave your IRA and your Roth IRA to your son and daughter.

When would you want them to pull the money out of the traditional IRA?

When would you want them to pull the money out of the Roth IRA?

You see, these decisions can impact the tax consequences your children experience with dramatic differences and effects.

We would never want to let our children leave the traditional IRA tax-deferred until the very last minute in the 10th year, and then be required to pull all of the funds out in one tax year, creating a huge taxable event. A much better way to plan for the traditional IRA is to strategically make IRA distributions over the 10 years, in a manner that does not push the beneficiaries into a tax bracket that is too high. This decision has to be made in concert with their other income sources each tax year over the 10-year period.

The Roth IRA on the other hand, is a whole different matter. For the Roth IRA, we will want to delay taking out distributions as long as possible. Using the Rule of 72 and assuming that the Roth IRA Account can grow at a rate of 7% per year, the Roth IRA account would likely double over the 10-year period. All of that growth would be income tax-free.

It would be a colossal mistake to take out the proceeds of the Roth IRA prior to pulling out funds from the traditional IRA. Making sure that your beneficiaries understand these concepts, or have competent tax and financial advisors advising them on the best way to deal with these distributions, is paramount in assuring their success in taking advantage of the tax laws that are available for the benefit of your family.

Leave More

The new advanced tax planning "IRA Beneficiary CRT" can provide income over your beneficiaries' lives.

Since the Secure Act has limited the pay-out time frame to just 10 years for most beneficiaries, a new (IBCRT)" IRA Beneficiary CRT" (IRA Beneficiary Charitable Remainder Trust) has emerged as a potential solution to the limitations of the Secure ACT.

By leaving some or all of your IRA to an IRA Beneficiary CRT, you can help your beneficiaries avoid having to pay a large portion of the IRA right up front to the Federal and State government.

Assume for one minute that your one million dollar IRA does not have to pay any taxes at your passing, and can be placed in the IRA Beneficiary CRT. The trust can immediately begin to pay out an income stream of 5% to your beneficiaries every year for the rest of their lives. If the account can grow more than 5% in a year, then the next year the income can actually increase.

After your children pass away this trust can continue to pay income to your grandchildren if they were alive before you died.

Here is how the math works: If you leave a one million dollar traditional IRA to your child, he/she will most likely have to pay around 35% in federal income tax, and let's say another 5% in state income tax for a total of 40%. That would only leave him/her with $600,000.00 to invest. At a 5% income rate that would provide them with $30,000.00 per year in taxable income.

If you leave the one million dollar traditional IRA to a (IBCRT) **"IRA beneficiary CRT"** the entire one million will be deposited into the trust account. Which can then pay 5% per year in income to your beneficiary. The payment can be made up of either capital gains or income. The payment will generally be determined at the end of each year based on the trust account balance. So, if the account has grown the 5% payment that year will be more than it was the previous year. The payment the first year from the trust would be 5% of the one million dollar trust account or $50,000.00.

See how the IBCRT will potentially provide for a bigger income stream to your beneficiaries. It is because the trust does not have to pay out the tax on the IRA balance when it is first distributed to the trust.

The payments of income from the trust to your beneficiaries are paid out without taxes having to be paid up front, ($600k vs. one million in the trust) potentially letting your beneficiaries receive a larger income stream over their lifetime.

I know some of you are worried that you don't want to disinherit your beneficiaries by leaving your IRA to the IRA Beneficiary CRT. All that has to be left to the charities in the end, is 10% of the actuarial value. Just remember, that you leave about 10% in the end to a charity. All of the trust balance until then, can be growing tax deferred for the benefit of your loved ones. It will be taxable income to your beneficiaries to the extent that you have growth and income inside of the trust account. You can essentially leave income for life to your children and grandchildren with this type of plan, and leave some to your charities as well.

You will not be disinheriting your children. You will potentially be leaving them the most income from your Traditional IRA that you can in light of the new Secure Act.

King Soloman IRA Beneficiary Planning that I find most Estate Planning attorneys never consider.

It's clean, elegant, and in-expensive

You may be thinking, "… but I want to let my beneficiaries receive some of my IRA funds right up front without any restrictions." Maybe not all of the account, but a large portion as a lump sum.

I have had many of my clients feel the same way. I would like to share with you the King Solomon IRA beneficiary plan concept.

Split your traditional IRA account into two IRA accounts. Leave one IRA account directly to your beneficiaries, and the other you can leave to the IRA Beneficiary Charitable Remainder Trust. You can split the IRA into any portion that you may desire.

For example, if you have a one million dollar traditional IRA, you may choose to leave your son or daughter $250,000.00 directly from the first IRA account. You can then leave the other $750,000 from the 2nd IRA account to an IRA Beneficiary CRT to provide an income benefit for the rest of your beneficiary's life.

I have found that many estate planning attorneys' natural inclination is to please you; they will generally try and solve this problem through the language of a trust. That can prove to be very tricky and will most certainly be overly complex with all of the IRA distribution rules that apply. Once provided with the option of splitting the IRA account into two separate accounts, most estate planning attorneys are generally very supportive of the simplicity, elegance, and power of this estate planning concept.

Remember, splitting your traditional IRA account (into multiple IRA accounts) in order to achieve your goals of leaving certain amounts of your IRA to certain beneficiaries can be an easy fix to what would otherwise be a big mess. You may want to leave a certain amount to a spouse, to a beneficiary with special needs, to your children, to children of a second marriage, to a charity of your choosing, or to an IRA Beneficiary CRT.

In the fee-based environment we live in today, it is not really any more expensive to have five traditional IRA accounts than it is to have one big IRA account.

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

Bruce Hosler is the Founder and Principal of Hosler Wealth Management LLC. He was named to the Forbes "Best-in-State Wealth Advisors" in Arizona for *six* consecutive years. As both a Tax accountant (EA) and Certified Financial Planning Professional®, he specializes in Advanced Tax Strategies to help his clients preserve and protect their wealth.

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You can find more information about Bruce at:
http://www.hoslerwm.com
or email him at info@hoslerwm.com

HOSLER WEALTH MANAGEMENT, LLC

Protecting & Preserving Wealth

700 S. Montezuma St. | Prescott, AZ 86303 | 928-778-7666

7400 E. Pinnacle Peak Rd. Suite #100 | Scottsdale, AZ 85255 | 480-994-7342

www.hoslerwm.com