# Understanding the Impact of the SECURE Act on IRA and Retirement Plan Inheritance Rules

By Lawrence C. FIORELLA
Financial Advisor

**THE SECURE ACT OF 2019** changes the way retirement plans can be passed along to an heir. Before the Act, beneficiaries of traditional Individual Retirement Accounts (IRAs) could stretch out required minimum distributions (RMDs) over their lifetime, thereby reducing the taxable income from inherited IRAs by spreading it our over several years, even decades. The provision also allowed for ongoing tax-deferred growth in the value of the inherited IRA. Now, for IRAs inherited from original owners who passed away on or after January 1, 2020, most non-spouse beneficiaries are required to withdraw assets from an inherited IRA or 401(k) plan within 10 years of the original account owner's death.

## RULES AND EXCEPTIONS

The new rules highlight a distinction between a traditional and Roth IRA and how an heir might deal with each. The shorter distribution period could result in unanticipated and potentially large tax bills for non-spouse beneficiaries who inherit high-value traditional IRAs. Plus, any funds not distributed by the 10-year deadline will be subject to an excise tax of 25 percent, as set by SECURE Act 2.0, which could be reduced to 10 percent if the account owner corrects the error by filing a Form 5329 for the year in which the full amount of the RMD was required and withdrawing the remainder of the account funds within two years of that original deadline. By contrast, the beneficiary of a Roth IRA and its tax-free distributions might want to leave the account intact for up to the full 10 years to benefit from the potential tax-free growth for as long as possible.

There are exceptions to the 10-year rule that apply to "eligible designated beneficiaries," which include 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; and disabled or chronically ill individuals, as defined by the IRS. However the 10-year distribution rule will apply to a child beneficiary when the child reaches age 21 or when a successor beneficiary inherits those account funds.

Eligible designated beneficiaries can use the old stretch IRA rules and take RMDs pro-rated based on their own life expectancies. In such cases, RMDs must begin no later than December 31 of the year after the original account owner's death. However, if the original owner was of RMD age and failed to take the required amount in the year of death, the beneficiary must take the RMD by December 31 of that year or be subject to the same 25 percent excise tax that applies with the 10-year rule. The IRS could, however, waive the tax due to reasonable cause.

Spousal beneficiaries can roll over the inherited IRA assets to their own IRAs. Or they can elect to treat a deceased account owner's IRA as their own if they are the sole beneficiary and the IRA trustee allows it. As the account owner, the surviving spouse could then make additional contributions, name new beneficiaries, and wait until age 73 (if they reach age 72 after December 31, 2022) to start taking RMDs. As of 2024, a surviving spouse who is the sole beneficiary of an employee who is a participant in a qualified work-based plan will be treated as the employee for the purposes of RMD rules. A surviving spouse who becomes the account owner of a Roth IRA is not required to take distributions.

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### TRUST PLANNING

With the stretch option eliminated, many high net-worth-investors are turning to trusts as an alternative way to pass down their retirement savings. Using a trust as beneficiary, the individual can choose who receives distributions from their account and when, including extending those payment periods beyond 10 years. Trusts also offer more control over how assets are distributed by protecting them from creditors and divorce settlements, and ensuring that they are used for intended purposes, such as education expenses or medical bills. Trusts can also be set up to continue distributing funds long after the trust owner passes away, allowing them to create a lasting legacy for generations to come.

As a financial advisor, I highly recommend that retirement account owners review their beneficiary designations with their financial or tax professional. While new rules may impact inheritances and taxes, other solutions are available, especially for individuals with substantial wealth. Trusts, for example, can offer a range of benefits, including asset protection and legacy planning. With professional guidance and careful planning, your retirement plan assets can become a lasting source of financial security for your loved ones long after you're gone.

For more information or to talk with an HBKS wealth advisor, call us at (716) 672-7800; or you can email me at lfiorella@hbkswealth.com.

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## Lawrence C. Fiorella

Financial Advisor, HBKS® Wealth Advisors

Lawrence Fiorella serves as a financial advisor in the HBKS® Fredonia, New York, office. He specializes in providing personal financial planning, including investments, retirement, protection planning, retirement income, estate planning strategies, education funding, tax management strategies and wealth preservation strategies. He can be reached at (716) 672-7800 or by email at lfiorella@hbkswealth.com



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