Planning in a post-SECURE Act World: Beneficiary designation considerations

On December 20, 2019, the most comprehensive new retirement legislation in well over a decade was signed into law. The Setting Every Community Up for Retirement Enhancement Act ("the SECURE Act") makes many significant changes to the ways you can save for retirement, and how you and your beneficiaries can benefit from those assets in the future. Most of the provisions became effective on January 1, 2020.

The main purpose of the SECURE Act is to increase access to employer-sponsored retirement plans and hopefully, to take a positive step toward addressing the national retirement crisis. There are many provisions related to the establishment of retirement plans for small businesses and the rules regarding employer plan access and offerings; however, this paper will focus on the most significant changes for individuals.

How does the SECURE Act impact you and your beneficiaries?

A summary of some of the key provisions of the SECURE Act affecting individuals is as follows:

- The age at which required minimum distributions ("RMDs") must begin has increased 18 months from age 70½ to age 72 for individuals who attain age 70½ after December 31, 2019 (those who attained age 70½ before this date are not affected and will continue to be subject to RMDs).
- The maximum age for contributions to traditional IRAs is eliminated, allowing individuals to contribute to IRAs after age 70½ (and can continue after age 72), provided they have earned income.
- The stretch option for inherited IRAs and qualified employer plans is eliminated for many beneficiaries and remains available only to those individuals who qualify as "eligible designated beneficiaries."
- Eligible designated beneficiaries are defined as spouses, minor children of the account owner (until age of majority), individuals who are disabled or are chronically ill and other beneficiaries who are less than ten years younger than the original account owner, as well as see-through trusts for the benefit of eligible designated beneficiaries in certain circumstances.
- All other designated beneficiaries who inherit retirement accounts from an individual who dies after December 31, 2019, will no longer be able to take advantage of the stretch option and are now required to withdraw the entire balance by the end of the tenth year following the year of death.
- The ten-year payout rule also applies to successor beneficiaries (the beneficiary's beneficiary) of inherited retirement accounts, regardless of when the original account owner died.[1]
- With respect to interests inherited under governmental plans (as defined in IRC section 414(d)), the changes to the distribution rules for designated beneficiaries (including the stretch IRA provision) will not take effect until January 1, 2022.

Planning for your beneficiaries in a post-SECURE Act world

How can you better plan for your beneficiaries?

While most of the SECURE Act changes relate to personal retirement planning, the loss of the stretch provision for many beneficiaries is likely to have the biggest impact on legacy and intergenerational wealth planning. Retirement accounts are often the largest asset we leave behind to our beneficiaries and the recent legislative changes may dramatically change the way you will want to plan for leaving those assets behind.

The SECURE Act creates new beneficiary categories, each with their own distribution options and rules, as detailed below:

Post-SECURE Act beneficiary categories and distribution options

Category	Beneficiary	Distribution options
Eligible designated beneficiary	▪ Spouses	▪ The surviving spouse may roll over the plan or IRA into his or her own name. In this case, the spouse is treated as the owner and all personal plan or IRA distribution rules apply. ▪ The surviving spouse may elect to treat the plan or IRA as an inherited plan or IRA and utilize the "stretch provision" by taking RMDs under the life expectancy method using the Single Life Table. The surviving spouse can subsequently roll over the inherited plan or IRA into his or her own name at any time. ▪ The surviving spouse may be able to elect the same ten-year payout option that is available to a designated beneficiary if plan rules allow.
Eligible designated beneficiary	▪ Minor children of the original account owner (up until age of majority) ▪ Disabled or chronically ill individuals ▪ Other individuals who are less than ten years younger than the original account owner ▪ Certain see-through trusts that benefit an eligible designated beneficiary	▪ The beneficiary may utilize the "stretch provision" and take RMDs under the life expectancy method using the Single Life Table. ▪ The beneficiary may be able to elect the same ten-year payout option that is available to a designated beneficiary if plan rules allow.
Designated beneficiary	▪ All other individuals who do not qualify as eligible designated beneficiaries ▪ See-through trusts that do not benefit only eligible designated beneficiaries	▪ The inherited plan or IRA must be withdrawn by the beneficiary by the end of the calendar year which contains the tenth anniversary of the original account owner's death. The beneficiary may withdraw any amount(s) at any time so long as the entire balance is withdrawn by 12/31 of the year of the tenth anniversary of the original account owner's death.
No designated beneficiary	▪ Estates ▪ Business entities ▪ Charities ▪ Trusts that do not qualify as see-through trusts	▪ The inherited plan or IRA must be withdrawn by the beneficiary by the end of the calendar year which contains the fifth anniversary of the original account owner's death. The beneficiary may withdraw any amount(s) at any time so long as the entire balance is withdrawn by 12/31 of the year of the fifth anniversary of the original account owner's death. ▪ If the original account owner died after attaining his or her required beginning date, the beneficiary can take RMDs over the original account owner's remaining life expectancy.

Prior to the passage of the SECURE Act, many non-spouse beneficiaries (e.g., children, grandchildren, nieces, nephews, etc.) who inherited retirement accounts were able to withdraw the assets over their own life expectancy under a concept known as the “stretch IRA.” This allowed for the assets to continue to grow tax deferred, and the beneficiary was only required to withdraw and pay applicable income taxes on an annual RMD amount based upon the beneficiary’s own life expectancy, an especially valuable payout option for younger beneficiaries. By way of example, a 45-year-old person who inherited an IRA from a parent or grandparent could stretch out the plan distributions over approximately 39 years (based on the current IRS life expectancy tables).

The SECURE Act has eliminated this stretch option for beneficiaries who do not qualify as an “eligible designated beneficiary.” All other individual designated beneficiaries must now withdraw the balance of an inherited retirement account by the end of the tenth year following the year of the plan participant’s or IRA owner’s death. The beneficiary can elect to withdraw the entire account in a single lump sum at any time within the ten-year period,[2] or can elect to withdraw in equal or unequal annual installments over ten years provided that the entire account is distributed by December 31 of the year that includes the ten-year anniversary of the original account owner’s death.

Using the same example as above, under the SECURE Act, that same 45-year-old person who inherits an IRA from a parent or grandparent will now be required to take a complete distribution of all plan assets within ten years of the year of death rather than 39 years. If the beneficiary is in his or her peak earning years at the time that he or she inherits, the income tax consequences may be significant.

With the stretch provision no longer available for many beneficiaries, passing on large taxable retirement accounts to family members and other loved ones could lead to a smaller inheritance than anticipated due to the income tax consequences created by the accelerated withdrawal requirements. It is now even more important to have a proper plan in place that puts your beneficiaries in the best position possible when it comes time for them to inherit your retirement accounts.

So what should you do now?

Review your beneficiary designations

Routinely revisiting the beneficiary designations on your retirement accounts to ensure that they remain in line with your current goals and wishes is always a good idea. It is especially important to review your beneficiary designations when there are any changes in the law that may impact your beneficiaries’ inheritance options and resulting tax liabilities. With the elimination of the stretch provision for many individual and trust beneficiaries, your existing beneficiary designations may no longer operate as you had intended.

Keep in mind that beneficiaries that were not previously entitled to the stretch provision because they failed to qualify as a designated beneficiary for IRS purposes (e.g., estates and certain trusts) will remain subject to the even more restrictive five-year withdrawal rule.[3] Accordingly, you will still want to confirm your retirement accounts include designated beneficiaries where appropriate.

Traditionally, having a spouse designated as the primary beneficiary and children or grandchildren (or trusts for children or grandchildren) designated as contingent beneficiaries was a common and tax-efficient way of transferring retirement assets to family members. Such a strategy will still work for many; however, there may be situations where that arrangement no longer provides the best outcome.

For example, if a surviving spouse does not necessarily need access to all of the decedent spouse’s retirement assets, it might create greater overall income tax efficiency to leave all or a portion of the retirement assets directly to children or grandchildren on the first spouse’s death and the balance of the surviving spouse’s remaining retirement assets to those same family members on the second spouse’s death. This strategy could create two separate ten-year withdrawal windows for your beneficiaries to be able to better manage the tax liability related to those inherited assets.

In a variation of that strategy, if you are not sure what the surviving spouse's needs might be when it comes to the decedent's retirement assets, you could continue to designate each spouse as the primary beneficiary and preserve the ability for the surviving spouse to decide whether those assets are personally needed at the time of the first spouse's death and if not, the surviving spouse could disclaim (i.e., renounce) all or a portion of those assets directly to the children or grandchildren who are designated as contingent beneficiaries.

Another option to consider is leaving your retirement accounts to a larger group of beneficiaries. This could help mitigate taxes by having the income tax liability shared amongst a greater number of individuals, each of whom will have their own personal ten-year timetables to withdraw their shares. For example, instead of leaving an account only to your children, you could include grandchildren as well, that way each beneficiary will be withdrawing from a smaller taxable share over their own separate ten-year time frames, with such taxable withdrawals being reported to each of them at their own respective income tax rates. Note, however, there are additional complexities involved when leaving large sums of money to minors, not the least of which is the fact that grandchildren, even when minors, do not qualify as eligible designated beneficiaries.

Please note that if you inherited a retirement account from an account owner who died prior to January 1, 2020, the payout options have not changed, and the stretch option continues to remain available to you. However, if there is a balance from the inherited account left behind on your passing, the SECURE Act rules will apply to the successor (second level) beneficiary of the original inherited account. Under the new rules, successor beneficiaries of inherited retirement accounts will need to withdraw the inherited balance in accordance with the ten-year payout rule. Therefore, it is important that you revisit the beneficiary designations on any previously inherited retirement accounts to make sure that proper planning is in place for your successor beneficiaries.

What to consider when naming a trust as beneficiary of a retirement account

In addition to individual beneficiaries, you should also review your beneficiary designations if your estate plan includes any trusts. Trusts have always provided an additional level of complexity when identified as the beneficiary of a retirement account. With the SECURE Act in place, there may be even more issues that need to be addressed when leaving your retirement assets to a trust.

A trust can still qualify as a designated beneficiary of a retirement account provided that it meets certain IRS guidelines. These trusts are referred to as "see-through" trusts and prior to the SECURE Act, were entitled to the same stretch benefits as an individual designated beneficiary. Therefore, the trustee of a see-through trust was able to defer taxes on any retirement account that was inherited by the trust and was only required to withdraw an annual RMD amount from the account based upon the life expectancy of the oldest beneficiary of the trust.

Under the SECURE Act, just like many individual beneficiaries, in most cases, trustees of see-through trusts must also withdraw the balance of any retirement account in accordance with the ten-year payout rule, if the trust beneficiary does not qualify as an eligible designated beneficiary. However, unlike individual beneficiaries who have complete discretion to determine the most appropriate ten-year drawdown and tax-planning strategy for themselves, a trustee's options will often be strictly dependent upon how the trust in question is drafted and the discretion it affords the trustee.

See-through trusts are designed to qualify for beneficial distribution options as either *conduit trusts* or *accumulation trusts*. Conduit trusts are traditionally structured to pass through any distribution the trust receives from a retirement account, usually (but not limited to) the RMD amount, directly to the underlying beneficiaries of the trust itself. As the name implies, an accumulation trust does not automatically pass out distributions to the trust beneficiary; rather, the trustee is either required or has discretion to accumulate distributions inside the trust and determine if and when distributions are made to a trust beneficiary.

Under the previous rules, a conduit trust had certain advantages when handling retirement accounts, as it helped create a lifetime income stream for the trust beneficiary while also being able to manage the tax liability related to distributions from retirement accounts. One reason for this is because individuals who received the RMDs from a conduit trust paid the income tax related to the RMDs at their (presumably) more favorable rate. When RMDs are accumulated inside the trust (i.e., not distributed to the trust beneficiaries), those amounts are taxed to the trust at generally higher trust income tax rates. This is due to the fact that trusts are subject to separate and far more compressed income tax brackets than individuals and reach the highest bracket at a significantly lower income threshold.

In the post-SECURE Act environment, only a very limited subset of see-through trusts will be able to qualify as eligible designated beneficiaries entitled to the stretch provision payout option. These include certain see-through trusts for the sole benefit of surviving spouses, disabled or chronically ill individuals, minor children of the original account owner (but only until attaining the age of majority), and other individuals less than ten years younger than the original account holder. All other see-through trusts will no longer be able to use the stretch provision payout option. Instead, the trustee will be required to withdraw the balance of any inherited retirement account in accordance with the ten-year payout rule.

For conduit trusts, the loss of the stretch provision may be problematic. For example, depending on the terms of the trust, the beneficiaries of a conduit trust may end up receiving larger distributions of taxable income over a much shorter period than the account owner had originally intended. Furthermore, some conduit trusts were designed to distribute only the RMD and under the SECURE Act, there will be no RMD until the final distribution year, potentially resulting in an unintended balloon payment. In addition to the income tax issues, accelerated distributions could present concerns for beneficiaries who are not in the best position to manage direct access to sizeable sums of money and for beneficiaries where the primary purpose of the trust is to provide asset protection from creditors or savings related to future estate or inheritance tax.

As illustrated on page 6, the SECURE Act could dramatically change how your retirement accounts are handled when left to a see-through conduit trust. Previously, conduit trusts would allow for the trustee to use the stretch option and distribute relatively small RMD amounts to a trust beneficiary spread out over his or her lifetime. Trustees now will be required to manage distribution of the entire balance of a retirement account over ten years, which could result in much larger annual payouts or even the distribution of a single lump sum directly to the trust beneficiary. This puts trustees in the difficult position of determining the timing and size of the distributions and the management of the related tax consequences.

This example shows the different results a see-through conduit trust can have for a 30-year-old trust beneficiary by comparing the “old” life expectancy rules to a couple of distribution scenarios under the new ten-year payout rules.

Conduit trust distribution options before and after the SECURE Act

Year after death	Age	Stretch IRA RMD method	10-year rule options	
			Equal schedule	Full deferral
0	30	$18,762	$142,378	$0
1	31	$20,100	$142,378	$0
2	32	$21,535	$142,378	$0
3	33	$23,072	$142,378	$0
4	34	$24,720	$142,378	$0
5	35	$26,486	$142,378	$0
6	36	$28,379	$142,378	$0
7	37	$30,409	$142,378	$0
8	38	$32,584	$142,378	$0
9	39	$34,917	$142,378	$0
10	40	$37,417	$142,378	$1,967,151

Assumes $1 million IRA at death of original account owner and a 7% growth rate.
*With permission from Keebler and Associates, LLP.

Now is the time to revisit any existing trust planning you have in place for the beneficiaries of your retirement assets. Your attorney can help you determine if any revisions are necessary as a result of the recent changes in law, including potentially changing any existing conduit trust planning to an accumulation trust. This could allow your trustee to have greater control and discretion over the timing and size of the trust distributions when considering what’s in the beneficiary’s best interest and tax efficiency.

Charitable giving

For those with charitable intentions, using pretax retirement dollars to fund your philanthropic goals and preserving more of your after-tax dollars for individual beneficiaries has always been a sound tax planning strategy. Under the SECURE Act, it has become even more important to make sure you are maximizing your retirement dollars with your charitable planning.

Charitable giving is another reason to take the time to revisit your retirement account beneficiary designations. This can help ensure that any charitable goals you have included in your estate plan are coming directly from your pretax assets first. Unlike individual beneficiaries, qualified charities do not pay income tax when they receive your retirement accounts. Keep in mind, however, that retirement accounts pass under the terms of the beneficiary designation and not under the terms of your will. Therefore, you should be sure to review your estate planning documents with your attorney to confirm that your retirement account beneficiary designations are coordinated with your overall estate plan.

You may also want to consider how you could benefit from lifetime charitable giving. This strategy not only gives you the satisfaction of seeing your charitable intentions carried out during your life but may also lower your own personal income taxes.

Individuals continue to have the opportunity to give to charity directly from IRAs by making a qualified charitable distribution or “QCD.” This allows an individual who is over the age of 70½ (the QCD age threshold remains unchanged under the SECURE Act) to make a distribution from an IRA of up to $100,000 per year directly to a qualified charity completely tax free.[4] While it is not required, a QCD can be applied to satisfy all or a portion of your IRA RMD for a given year. The benefit of doing so is that the RMD amount that is satisfied by the QCD is not included in your adjusted gross income (AGI) for the year of the distribution. As a result, QCDs can help lower your income taxes during your lifetime while also reducing the amount of taxable dollars you leave behind at death.

A second charitable giving strategy to consider is a charitable remainder trust or “CRT.” A CRT is an irrevocable trust that distributes a fixed amount or a percentage of the trust assets to one or more individual beneficiaries for their lifetime or for a term of up to 20 years. At the end of the term, the trust terminates and the balance of the assets is paid to charity. Because a CRT is itself a charitable entity, you will receive either an income tax deduction (for gifts made during your lifetime) or an estate tax deduction (for gifts made at death) equal to the actuarially calculated amount that will pass to charity when the trust terminates.

With the elimination of the stretch provision for most non-spouse beneficiaries, this type of charitable giving vehicle could become an effective planning tool when leaving retirement assets behind. Instead of giving retirement dollars directly to individuals who would then have to quickly recognize the full tax liability of those dollars over the next ten years, those that are charitably inclined could designate a CRT as the beneficiary and create a lifetime income stream for an individual beneficiary similar to the previously available stretch provision with the remaining balance going to charity on their passing.

Asset location

When it comes to leaving wealth to the next generation, funding traditional retirement accounts alone may not be the most effective planning strategy. You might want to think about implementing a comprehensive financial plan that creates more after-tax dollars to leave behind to your family members and other loved ones.

So how can you create more after-tax wealth for your heirs?

Life insurance

Funding a life insurance policy is one strategy that can be used to pass on a sizeable income tax-free death benefit to your beneficiaries. Just like the tax benefits related to retirement accounts are designed for retirement accumulation, the tax benefits of life insurance are designed to enhance legacy wealth transfer.

After your death (or the death of you and your spouse in the case of a second-to-die policy), the life insurance policy death benefit could help offset the income tax liability associated with your retirement accounts and serve as a readily available resource for your beneficiaries to use to pay such taxes. The liquidity of the death benefit will also give your beneficiaries greater flexibility to be able to develop an investment strategy that can be best suited for them moving forward. When compared to retirement accounts, a life insurance policy could provide a lot more certainty and efficiency when funding trusts for your beneficiaries, including special needs trusts for disabled individuals.

Surplus income from employment while you are working or from RMDs during retirement could provide an ideal resource to fund life insurance premiums. For individuals with estate tax concerns, creating an irrevocable life insurance trust to own the policy may create even greater tax savings, since the trust could pass the death benefit to your beneficiaries free from both income and estate tax.

Roth accounts and conversions

For those interested in leaving behind tax-free retirement dollars to beneficiaries, under the SECURE Act, Roth accounts may become an even more effective tax-planning opportunity than previously thought. Unlike traditional IRAs, Roth IRA contributions are made from after-tax dollars and are not tax deductible. As a result, qualified withdrawals are generally income tax free—a big advantage over withdrawals from traditional IRAs, which are taxed as ordinary income.

Contributing to a Roth account is limited to individuals under certain income thresholds. However, individuals with existing traditional retirement accounts can use Roth conversions to convert pretax retirement dollars in a traditional account to income tax-free dollars in a Roth account. A Roth conversion is done by converting or “rolling over” amounts from an existing traditional IRA and/or tax-qualified plan, such as a 403(b), 401(k) or 457, into a Roth account and paying the associated income tax liability. You may convert any amount from a traditional IRA to a Roth IRA regardless of your income or filing status.

By paying the income tax on your retirement dollars now, you can take advantage of today’s historically low income tax rates while allowing your heirs to inherit those retirement dollars completely income tax free (with certain exceptions) in the future. This can be especially effective if your designated beneficiaries are (or will be) in a higher tax bracket than you.

Roth conversions can be especially attractive for those with large retirement account balances who plan to retire before reaching RMD age. Those individuals may find themselves in a period of low income years after leaving employment and before having to start receiving taxable RMDs from their retirement accounts, which could provide a nice window to convert those dollars at a relatively low tax rate.

Under the SECURE Act, inherited Roth accounts are subject to the same ten-year withdrawal rules as traditional retirement accounts for many beneficiaries. However, the distributions from such accounts generally are not subject to income tax and will allow for continued tax-free growth until the account is fully withdrawn.

As the SECURE Act changes the way your retirement accounts are treated, you want to make sure your retirement planning is changing with it. That’s where TIAA can help. We encourage you to meet with a TIAA Wealth Management Advisor so that we can help get you properly prepared.

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[1] A successor beneficiary who inherits an inherited retirement account from an eligible designated beneficiary has the full ten-year withdrawal period, while a successor beneficiary who inherits from a beneficiary who already was subject to a five-year or ten-year withdrawal period succeeds only to the remaining portion of the original withdrawal period.

[2] The “ten-year period” is calculated as ten years plus the number of days from the decedent’s date of death until the end of the year of death.

[3] These beneficiaries may also have the option to take RMDs using the original account owner’s remaining life expectancy if the account was inherited from a decedent who had already attained RMD age at time of death. As with the new ten-year rule, once a five-year withdrawal period commences, it applies to all successor beneficiaries; they do not get a new five-year period.

[4] Under the SECURE Act, QCD amounts will be reduced by the aggregate amount of any deductible IRA contributions made after age 70½.

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