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Stretch Demise Mandates Beneficiary Review

The SECURE Act is now law. In addition to making other changes to retirement plans and IRAs, the Act significantly changed the rules on distributions for deaths occurring after December 31, 2019.

Stretch Distribution Over Beneficiary's Life Eliminated.

Under the old rules, with proper planning the life expectancy of the beneficiary could generally be utilized to determine the minimum annual distribution requirement (RMD). For example, if the beneficiary of an IRA is age 50 under the old rule distributions could be taken out over 34.2 years. This distribution option was referred to as "stretch."

> The Secure Act eliminated the stretch option for all but five classes of so called "eligible designated beneficiaries." Eligible designated beneficiaries who can still receive stretch distributions include surviving spouse, children of the plan/IRA owner who have not reached age of majority, disabled/chronically ill individuals, and beneficiaries that are not more than 10 years younger than the plan/IRA owner.

For all other "designated beneficiaries," the stretch rules are replaced with a rule requiring that all distributions from defined contribution retirement plans and IRAs be distributed in its entirety by the end of the tenth (10th) year following the year of death of the owner. Technically, the annual RMD is replaced with a single RMD that occurs 10 years following the year of the participant's death. This distribution is referred to as the 10-year rule. **Considering the new distribution requirements, it is imperative that your clients have all their beneficiary designations reviewed.**

Situations Where Designated Beneficiary May Need Revision.

The new distribution rules may totally disrupt the distribution plans of your clients. **Even the surviving spouse, who is the most frequently used beneficiary, may require reconsideration.**

When a surviving spouse is the designated beneficiary, s/he qualifies as an eligible beneficiary and can stretch distributions over life expectancy. However, on the death of the spouse where the beneficiary is a child or children, distributions will generally need to comply with the 10-year rule. When the spouse does not need all the plan values to maintain his/her standard of living, the participant could consider making the children a partial beneficiary instead of passing the entire IRA balance to a spouse. This strategy can result in two 10-year distributions instead of one.

Comparison of Stretch to 10-Year Distribution

Yr	Age	RMD Factor	Stretch Distribute	RMD Factor	10-Yr Distribution
1	59	27.9	40,842	0	154,820
2	60	26.9	43,383	0	154,820
3	61	25.9	46,087	0	154,820
4	62	24.9	48,963	0	154,820
5	63	23.9	52,024	0	154,820
6	64	22.9	55,282	0	154,820
7	65	21.9	58,750	0	154,820

Many clients have trusts in place for distributions to children. When a trust is named as the beneficiary, the determination of who a designated beneficiary is can be challenging when there are contingent beneficiaries. A conduit trust is often used to avoid this problem. Many clients have conduit provisions that simply state that the RMD amount must be distributed. Under the old rules, this resulted in annual distributions over the child's life expectancy. However, with the new rules, unless the child is a minor, all of the IRA must be distributed in a single year at the end of the 10th year following the death of the IRA owner. That is nine years with no distribution, ending with a tenth year of a huge distribution of money and significant income taxes. Even if the beneficiary of the conduit is a minor child that can use his or her life expectancy for distribution purposes, once the child attains the age of majority, the 10-year rule kicks in. I**nstead of using a conduit trust, the beneficiary can be an accumulation trust. With an accumulation trust, distributions from the IRA can be retained by the trust after the 10-year period and left to the trustee to make discretionary distributions. This results in trust level income taxation.**

How Can DBS Help?

Suffice it to say, everyone should revisit their beneficiary designations to make sure the distribution still makes sense. Some beneficiary designations will not require any change even though the new law will require accelerated distributions. Because the 10-year rule replaces the stretch rules in many cases, distributions will need to be made more rapidly than previously anticipated and the associated income tax will need to be paid when distributed. Acknowledging and planning for this is still necessary, even if no changes are made to the beneficiary designations. It may be appropriate for your clients to purchase life insurance to help deal with the accelerated income taxes.

Contact Terri Getman, DBS's in-house advanced case design resource at extension 230 for an illustration of how the 10-year rule may impact your clients.