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TAX AND WEALTH ADVISOR ALERT: NOT FEELING SO SECURE: PROPOSED LAW COULD BE COSTLY FOR NON-SPOUSE IRA BENEFICIARIES

On May 23, 2019, the House overwhelmingly voted (417-3) to approve the SECURE (Setting Every Community Up for Retirement Enhancement) Act and sent it to the Senate for their approval. The bipartisan bill is grabbing headlines for its modification to many retirement issues. Among those modifications is a requirement that could be costly for non-spouse IRA beneficiaries. The requirement forces non-spouse beneficiaries of inherited IRAs to withdraw funds from their account over a 10-year period after the original owner's death rather than the beneficiaries' life expectancy, ending the beneficial tax strategy known as the "stretch IRA."

Under current law, if a person other than a spouse is named as a beneficiary of an IRA account, the beneficiary can take their IRA required minimum distributions over their life expectancy based on a table provided by the IRS. Therefore, withdrawal of the IRA account is "stretched" out over a presumably long period based on the beneficiary's life expectancy. For example, if a 25-year old inherited a $1 million IRA from his grandfather, he would take distributions over his life expectancy of 57.2 years (as provided by the IRS table). His required minimum distributions would be about $17,482 ($1,000,000/57.2), which he would need to withdraw yearly over a 57.2-year period. Each year, this would result in a federal tax bill anywhere between $548 (if he were in the lowest tax bracket) to $6,468 (if he were in the highest tax bracket). The "stretch IRA" is a beneficial tax strategy, especially for younger beneficiaries, because they have smaller required minimum distributions stretched out through their life expectancy and thus they incur smaller tax bills. Additionally, the stretch allows for tax-deferred growth over longer accumulation periods and a larger amount of money reaching the pockets of the beneficiaries.

The proposed SECURE Act, however, would require beneficiaries to withdraw all the money in the inherited IRA account within a 10-year period from the original owner's death rather than stretch the distributions out over the life expectancy of the beneficiary. The proposed Act allows the distributions to be whenever the beneficiary likes—the distributions can be made at regular intervals or at the end of the period—just as long as they are made sometime in

the 10-year period.

Despite the flexibility in distributions, removing the stretch based on life expectancy in exchange for a 10-year period will have significant financial effects for non-spouse beneficiaries of inherited IRAs. The proposed Act will greatly accelerate tax collection, pushing the beneficiaries into high tax brackets, resulting in beneficiaries paying a substantial amount more in taxes than under the life-expectancy stretch. To illustrate, using the previously mentioned example of the 25-year old beneficiary of a $1 million IRA, if he were to take equal distributions of $100,000 over the 10-year period, in the first year alone, his income would be bumped up by $82,517 ($100,000 versus $17,482 in life-expectancy stretch), which could easily land him in a higher tax bracket. He would then have a yearly tax bill between $24,000 (if the distributions were his only income) to $37,000 (if he were in the highest tax bracket). That is an incredible difference in tax bills, not to mention the loss of tax-free compounding that was allowed for longer periods of time under the life-expectancy stretch.

If the proposed SECURE Act goes into effect, it will no doubt be costly for non-spouse IRA beneficiaries. The landscape of IRA planning will need to change, and IRA owners might consider alternative planning strategies like charitable beneficiaries or investments in life insurance policies versus IRAs to minimize taxes for their loved ones. While we wait to see if the Senate will approve the SECURE Act, we will continue to advise our clients to ensure their compliance and counsel on effective tax minimizing alternatives should the SECURE Act go into effect.

If you are interested in learning more about tax minimizing alternatives for non-spouse IRA beneficiaries, please contact Attorney Britany E. Morrison at O’Neil Cannon to discuss how we are able to assist you in your needs.