WELLS FARGO Advisors

Five beneficiary planning strategies

Many people invest their retirement savings in IRAs because they offer tax advantages, flexible options for accessing the money in retirement, and a simple way to pass wealth along to heirs. However, without thoughtful beneficiary planning, what should have been simple — can quickly become complicated. As you think about passing your wealth along to your heirs, consider the following five strategies.

1. Beneficiary distribution strategy

If one of your primary goals is to transfer wealth and build a legacy for your children or grandchildren, then you need to understand how the Setting Every Community Up for Retirement Enhancement (SECURE) Act has changed distribution options for most non-spouse IRA beneficiaries. The two categories of individual beneficiaries are either a Designated Beneficiary (DB) or an Eligible Designated Beneficiary (EDB).

A DB is a non-spouse individual who will have to empty their Inherited IRA by the 10th year following the year of your death. Distributions may be required before the 10th year. Depending on the size of the account, the DB may want to spread distributions over the 10-year period. If your beneficiary is inheriting a Traditional IRA, income tax will apply to taxable amounts when distributions are taken.

> Keep in mind for all of these strategies, once a distribution is taken, your beneficiary will not be able to put it back in their Inherited IRA because contributions including 60-day rollovers are not allowed in these accounts. Unless the beneficiary is your spouse, they cannot roll this money into their own IRA.

Larger dollar amounts can quickly put them into a higher tax bracket, whereas taking smaller distributions over the 10-year period can help avoid a significant tax bill. You may want to consider a Roth conversion to help them better manage taxes. Of course, you will also have to determine how a Roth conversion would impact your tax burden.

An EDB is a surviving spouse; a disabled or chronically ill individual; individuals not more than 10 years younger, the same age as, or older than IRA owner; or a child of the account owner who is age 21 or younger. EDBs have the most favorable distribution options. EDBs can take distributions from their Inherited IRA based on their own life expectancies. The life expectancy option is often referred to as the stretch IRA strategy. The year after the minor turns age 21, they will have 10 years to empty their Inherited IRA.

The stretch IRA strategy minimizes how much must be taken out of the Inherited IRA each year and, more importantly, allows the funds remaining in the account to continue to potentially grow on a tax-advantaged basis. This avoids a large, generally taxable, lump-sum distribution to the beneficiary. Beneficiaries may always take more than the RMD, but are not mandated to do so. While Inherited IRA distributions may be subject to ordinary income tax, there is no 10% additional tax for early, or pre-59½ distributions.

You need to carefully consider who you name as your IRA beneficiary and understand their distribution options. Naming a trust or your estate can limit the tax benefits and length of time the assets can stay in the Inherited IRA, diminishing the effectiveness of this plan.

2. Disclaiming strategy

Disclaiming may be a great post-death strategy if you have planned correctly by naming outright your spouse, children, or other individuals who are to inherit the IRA. This strategy allows your named beneficiary to determine, after your death, if they will need the money. If they won't, they can disclaim (refuse) the inheritance, passing the assets to the other IRA beneficiaries you have named. This is a key reason to name primary and contingent beneficiaries. It is important to know that the person disclaiming is considered to have predeceased you, the IRA owner, and the person disclaiming cannot dictate who will inherit the IRA. Instead, the IRA passes to any other named primary beneficiaries or if none, then to your named contingent beneficiary(ies). The IRA default beneficiaries may be used if there are no valid beneficiaries on file.

Hypothetical disclaiming example: Randy has named his wife Shelley as his primary beneficiary and their two children, Jared and Hoda, as his contingent beneficiaries. Upon Randy's death, Shelley meets with her financial professionals and determines she has enough assets outside the IRA and would like to disclaim the IRA. By disclaiming, Randy's contingent beneficiaries, Jared and Hoda, are able to establish Inherited IRAs and take distributions based on their beneficiary category.

3. Standard vs. per stirpes designation strategy

Choosing a beneficiary for your IRA is an important decision; however, knowing how your assets can pass to your heirs through the standard or per stirpes beneficiary designation is just as important. Most IRA contracts have a standard designation where your beneficiary must be alive upon your death to inherit their share. An IRA with Wells Fargo Advisors lets you choose between a standard designation or a per stirpes designation. With a per stirpes designation, if a beneficiary predeceases you, and you do not update your beneficiary designations or a beneficiary disclaims their portion, their share would go to their lineal descendants; usually their children. Any named beneficiary who predeceases you and has no lineal descendants, if a per stirpes designation was selected, will follow the standard designation. Keep in mind that a spouse is not an heir under a per stirpes designation.

Hypothetical per stirpes example: You have designated that your two children, Asha and Jack, are to equally inherit your IRA assets — 50% to Asha and 50% to Jack. With a standard designation, if Asha has predeceased you, her 50% share will go to Jack and he will receive 100% of the assets. If, instead, you wish Asha's children (your grandchildren) to inherit her share, a per stirpes designation is necessary. So, if Asha predeceases you or disclaims her inherited portion within 9 months of your death, Jack will still retain his 50% share, and under a per-stirpes designation Asha's 50% portion will divide equally among her children.

4. Roth conversion strategy

A Roth conversion is one financial strategy that is often overlooked when evaluating estate planning options. Learning about Roth IRA conversions may be a sensible step whether you are designing a comprehensive estate plan, trying to maximize your legacy, or passing your IRA to your heirs in the most tax-efficient manner. Before taking action, you need to consider the benefits of converting your taxable retirement accounts and the rules governing beneficiaries.

Converting allows you to reposition your existing tax-deferred retirement accounts such as Traditional, SEP, and (after two years) SIMPLE IRAs or qualified employer sponsored retirement plan (QRP) such as a 401(k) (if eligible for distribution) to a tax-free Roth IRA by paying federal and possibly state income tax on the taxable amount of the conversion. Remember, you will not owe an IRS 10% additional tax on the amount converted, and as the Roth IRA owner you are not subject to RMDs during your lifetime. You may owe the 10% additional tax on any amount withheld for taxes on the amount converted, if you are younger than age 59½. This optimizes the opportunity to build tax-free wealth that can be passed to your heirs. An EDB can take advantage of the stretch IRA strategy by beginning RMDs following the year of your death. A DB could wait until the end of the 10th year before taking any distributions, allowing potential earnings to grow tax-free. These distributions would be tax-free as long as the Roth IRA had been funded for more than five years.

5. Your Wells Fargo Advisors IRA strategy

The Wells Fargo Clearing Services (WFCS) IRA Disclosure Statement and Custodial Agreement can help protect you and your heirs. The first way is through the default beneficiary provisions. While it is recommended that you review and update your beneficiaries listed on your retirement accounts, at any life event such as a birth, death of a beneficiary, divorce, or marriage — that doesn't always happen. Only if your named beneficiaries have predeceased you or disclaimed, and a per stirpes designation was not elected or there is no valid beneficiary form on file, will the default provisions be used. The default beneficiaries on a WFCS IRA are:

- First, a surviving spouse
- Second, surviving children (as defined under state law)
- Third, your estate

The WFCS IRA Custodial Agreement includes the surviving children so that they retain the ability to establish Inherited IRAs.

A second provision in the WFCS IRA Custodial Agreement that should be noted is regarding divorce. The agreement specifically states if you are divorced at the time of your death and an ex-spouse is listed as your beneficiary, he or she is considered to have predeceased you. Therefore, they are not considered a beneficiary to your IRA assets. If you wish your ex-spouse to inherit the IRA, you would need to name them as your beneficiary **after** the date of divorce.

It is important to note that IRAs not held at Wells Fargo Advisors may not have the same provisions regarding default beneficiaries and divorce. If this is a concern, you may want to discuss consolidation with your Wells Fargo Advisors financial advisor to evaluate if this option is in your best interest.

Stay up to date

Undoubtedly, there are many considerations when naming beneficiaries and it's best to consult with your legal and financial advisors to align with your current estate plan. Do not forget that your will or trust does not supersede the beneficiaries listed on your retirement plan assets. You can update your IRA beneficiary designations at any time by completing and returning a signed beneficiary designation form.

Talk with Wells Fargo Advisors

These five strategies offer education and guidance to get you started on your beneficiary planning. However, your financial advisor can meet with you one on one to provide personalized recommendations and help create a plan for distributing your retirement assets that is appropriate for you — and your legacy.

With you every step of the way

Everyone has a different vision of retirement that requires a unique financial strategy. Wells Fargo Advisors can support you in your retirement planning process by providing the guidance needed to make informed choices. We will meet with you and help create a comprehensive plan that takes into account your complete financial picture. Your financial advisor will be with you every step of the way to meet to review your progress and adapt your plan as needed. Working together, we'll design and implement an investment plan that can help you live out your unique vision of retirement.