

# Choosing Beneficiaries for your Retirement Assets

The Setting Every Community Up for Retirement Enhancement (SECURE) Act has changed the distribution options for some beneficiaries. It is important that you understand these rules because many individuals don't know that how the assets are distributed depends on the beneficiaries selected. You know that Individual Retirement Accounts (IRAs) and qualified employer sponsored retirement plans (QRPs) provide a tax-efficient means to save for retirement. They can also provide a legacy for your heirs with proper planning. Did you know that who you name determines how long the assets can stay in the Inherited IRA and how quickly they may potentially be taxed? That's why proper planning is important: so you can affect the way your retirement savings will be inherited.

## Three categories of beneficiaries

You are asked to make a very important decision on each retirement plan you have — who to designate as your beneficiary(ies). Before making that designation, you need to understand that the category your named beneficiary is included in will determine their distribution rules.

Non-Designated Beneficiary (NDB)	Designated Beneficiary (DB)	Eligible Designated Beneficiary (EDB)
<ul style="list-style-type: none"> <li>• Estate</li> <li>• Non-qualified trust</li> <li>• Charity</li> </ul>	<ul style="list-style-type: none"> <li>• Non-spouse individuals more than 10 years younger than IRA owner</li> <li>• Non-spouse individuals who are not disabled or chronically ill</li> <li>• Primary beneficiary of qualified “look-through” trust who is <b>not</b> the surviving spouse, or disabled or chronically ill individual</li> <li>• Child of the IRA owner who has reached age 21</li> </ul>	<ul style="list-style-type: none"> <li>• Surviving spouses</li> <li>• Disabled or chronically ill individuals</li> <li>• Individuals not more than 10 years younger, the same age as, or older than IRA owner</li> <li>• Primary beneficiary of qualified “look-through” trust who is the surviving spouse, or disabled or chronically ill individual</li> <li>• Child of the IRA owner who has not reached age 21</li> </ul>

## Primary and contingent beneficiaries

You may have noticed that you can name “primary” and “contingent (secondary)” beneficiaries to your IRA. The primary beneficiary is entitled to receive the inherited IRA balance first. The contingent beneficiary inherits the funds only if the primary beneficiary(ies) dies prior to the IRA owner or disclaims, and a per stirpes designation was not elected. You can select one or more primary and/or contingent beneficiaries. In the case of multiple beneficiaries, you can designate the percentage each receives.

**Investment and Insurance Products are:**

- **Not Insured by the FDIC or Any Federal Government Agency**
- **Not a Deposit or Other Obligation of, or Guaranteed by, the Bank or Any Bank Affiliate**
- **Subject to Investment Risks, Including Possible Loss of the Principal Amount Invested**

## Spouse versus non-spouse beneficiaries

**Naming your spouse** — Naming your spouse as beneficiary may be a natural step, but there are additional reasons why this may make sense for many married couples. When an IRA passes directly to a spouse, in most cases, the assets will have the advantages of bypassing probate and qualifying for the unlimited marital deduction. Your spouse also has the right to treat the IRA as their own, by rolling into an IRA in their name.

A spouse beneficiary who inherits a QRP can roll these assets to their own Traditional and or Roth IRA or make a direct trustee-to-trustee transfer to an Inherited Traditional or an Inherited Roth IRA. Non-designated Roth account assets rolled over to a Roth IRA or transferred to an Inherited Roth IRA would be considered a conversion from the plan to the Roth or Inherited Roth IRA, triggering taxes on any taxable amount converted.

**Naming a non-spouse** — When you designate a non-spouse beneficiary, such as children, grandchildren, or friends, they are not allowed to roll the assets into an IRA in their name. Instead, they may transfer the money to an Inherited IRA to continue the tax-advantaged account status.

A non-spouse beneficiary who inherits a QRP can directly roll the plan balance to an Inherited Traditional IRA. They can directly roll designated Roth account assets to Inherited Roth IRA.

They can also choose to convert QRP balances to an Inherited Roth IRA, triggering taxes on any amount included in gross income.

## Other non-spouse beneficiaries

Entities such as trusts, estates, or charities may be named as a beneficiary but often they are not the best option. When a non-qualified trust, a charity or an estate is named as the IRA beneficiary; the options for distribution are limited.

## Beneficiary distribution options

The following tables summarize the distribution options a beneficiary has from an Inherited IRA if you have died either before or on or after your required beginning date (RBD), generally April 1 following the year you reach age 73.

Beneficiary category – individual	Life expectancy	10-year rule	10-year rule with RMDs <sup>1</sup>
<b>Designated beneficiary:</b>			
<b>Non-spouse more than 10 years younger than IRA owner, not chronically ill, or disabled, or minor not IRA owner's child</b>			
• Original IRA owner dies <b>before</b> RBD		X	
• Original IRA owner dies <b>on or after</b> RBD			X
<b>Eligible designated beneficiary:</b>			
Spouse			
• Original IRA owner dies <b>before</b> RBD	X	X	
• Original IRA owner dies <b>on or after</b> RBD	X		X
Disabled or chronically ill individuals			
• Original IRA owner dies <b>before</b> RBD	X	X	
• Original IRA owner dies <b>on or after</b> RBD	X		X
Individuals not more than 10 years younger, the same age as, or older than IRA owner			
• Original IRA owner dies <b>before</b> RBD	X	X	
• Original IRA owner dies <b>on or after</b> RBD	X		X

Child of the IRA owner who has not reached age of 21			
• Original IRA owner dies <b>before</b> RBD	X	X	
• Original IRA owner dies <b>on or after</b> RBD	X		X

Beneficiary category – entity	Life expectancy	5-year rule	10-year rule	10-year rule with RMDs <sup>1</sup>
<b>Non-Designated beneficiary:</b>				
Non-Qualified Trust or Estate or Charity				
• Original IRA owner dies <b>before</b> RBD		X		
• Original IRA owner dies <b>on or after</b> RBD	X <sup>2</sup>			
<b>Designated beneficiary:</b>				
Primary beneficiary of qualified trust <sup>3</sup> is a DB				
• Original IRA owner dies <b>before</b> RBD			X	
• Original IRA owner dies <b>on or after</b> RBD				X
<b>Eligible Designated beneficiary:</b>				
Primary beneficiary of qualified trust <sup>3</sup> is a EDB				
• Original IRA owner dies <b>before</b> RBD	X		X	
• Original IRA owner dies <b>on or after</b> RBD	X			X

<sup>1</sup> These regulations are final, IRS Federal Register 2024-14542 states RMDs will apply for calendar years beginning in 2025. Clients should also consult their tax professional for further guidance. Review the final IRS guidance via the Federal Register if you'd like to learn more.

<sup>2</sup> RMDs based on owner's age in year of death, divisor reduced by one each subsequent year.

<sup>3</sup> The type of qualified trust (e.g. conduit or accumulation) and who the original trust beneficiary is makes a difference in how long the Inherited IRA for the trust can remain open. It also depends on if the trust that inherited the IRA has one or more than one beneficiary. Please note WFA does not interpret the trust and the trustee should seek competent advice to determine their exact distribution options based on their situation.

### Designated beneficiary

Under the SECURE Act, these beneficiaries will now be subject to the 10-year rule.

**10-year rule** — This rule is applicable to both Inherited Traditional and Inherited Roth IRAs. The Inherited IRA must be emptied by the 10th year following the year of your death. If you die on or after your RBD, the DB must take required minimum distributions (RMDs) based on their life expectancy during the 10-year period. If you die before your RBD or the IRA is a Roth, then no distributions are required before the 10th year. Depending on the size of the account, a beneficiary may want to spread distributions over the entire 10-year period.

### Eligible designated beneficiary

This category has the most favorable distribution options. Beneficiaries can take RMDs from their Inherited IRA based on their own life expectancies. The life expectancy option is often referred to as the stretch IRA strategy<sup>4</sup>.

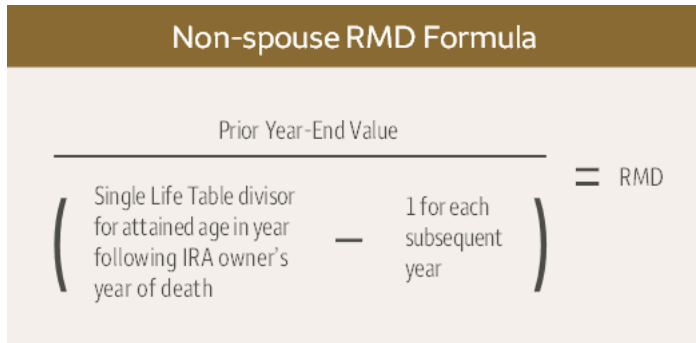
Your minor children can take RMDs based on their life expectancy until they reach the age of 21. Then they are subject to the 10-year rule. If you die on or after your RBD, RMDs would be required during the 10-year period.

## Inherited IRA distribution options for EDB

**Life expectancy** — This option is available for Inherited Roth and Inherited Traditional IRAs. The Wells Fargo Clearing Services, (WFCS) LLC IRA Custodial Agreement default is the Life Expectancy option. Your beneficiary may be subject to an IRS 25% excise tax for every dollar under- distributed. This tax can be reduced to 10% if corrected within two years from the date the tax is imposed.

**Non-spouse beneficiary** — This beneficiary will take annual RMDs, and can take more than that amount if they choose to. RMDs are based on their life expectancy using a divisor from the IRS Single Life Table and the prior year-end IRA value, on a term-certain basis. Qualified trusts use the age of the oldest trust beneficiary. Term-certain means that one is subtracted from the original divisor in each subsequent year. These RMDs will begin the year following your death.

**Please note that the stretch IRA strategy is designed for investors who will not need the money in the account for their own retirement. There is no guarantee that there will be assets remaining in the account at the time of the IRA owner's death.<sup>5</sup>**



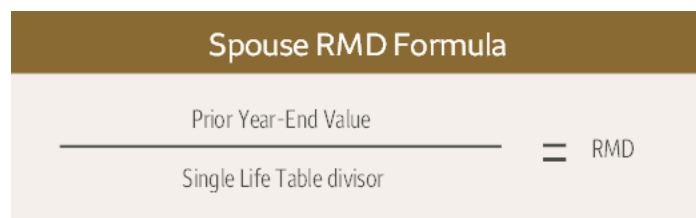
The diagram shows the formula for Non-spouse RMD. It consists of a brown header with the text "Non-spouse RMD Formula". Below the header, the formula is presented as follows: "Prior Year-End Value" is written above a horizontal line. Below the line, the denominator is shown as a fraction: "Single Life Table divisor for attained age in year following IRA owner's year of death" over "1 for each subsequent year". To the right of the fraction is an equals sign followed by "RMD".

$$\frac{\text{Prior Year-End Value}}{\left( \begin{array}{l} \text{Single Life Table divisor} \\ \text{for attained age in year} \\ \text{following IRA owner's} \\ \text{year of death} \end{array} - \begin{array}{l} \text{1 for each} \\ \text{subsequent} \\ \text{year} \end{array} \right)} = \text{RMD}$$

**Spouse beneficiary** — Establishing an Inherited IRA when your spouse is under age 59½ allows them to avoid the 10% additional tax on pre-59½ distributions (10% additional tax) that they might have if the assets were taken from their own IRA. They can always transfer the Inherited IRA to their own IRA, even if they have been taking distributions. RMDs from this Inherited IRA will start:

- The year you (deceased spouse) would have reached age 73 or
- The year following your death, if you died on or after your RBD.

Annual RMD calculations are based on your surviving spouse's life expectancy using a divisor from the IRS Single Life Table, the prior year-end IRA value, and utilizes the recalculation method. The recalculation method uses a new divisor from the table each year.



The diagram shows the formula for Spouse RMD. It consists of a brown header with the text "Spouse RMD Formula". Below the header, the formula is presented as follows: "Prior Year-End Value" is written above a horizontal line. Below the line, the denominator is "Single Life Table divisor". To the right of the fraction is an equals sign followed by "RMD".

$$\frac{\text{Prior Year-End Value}}{\text{Single Life Table divisor}} = \text{RMD}$$

<sup>4</sup>Stretching an IRA simply refers to the ability to take RMDs over the beneficiary's single life expectancy (using the term-certain calculation method) rather than over the life expectancy of the original IRA owner.

<sup>5</sup>When deciding whether to initiate a stretch IRA strategy, an investor should consider such factors as possible changes to tax laws, the impact of inflation, and other risks. Please note that designating a beneficiary two or more generations below the IRA owner may result in additional taxes when the distribution is made (exemptions may apply). Please consult with your tax advisor for more information.

**Rollover/transfer to own IRA** — Only a spouse can roll over or transfer the funds into an IRA in his/her own name. An IRA keeps the funds in a tax-advantaged account and defers income taxes, if due, until distributions are taken. IRA distribution rules will apply based on the surviving spouse's age — meaning no RMDs from their Traditional IRA until he/she reaches RMD age and no RMDs from their Roth IRA. However, it may make sense for your surviving spouse to open an Inherited IRA because distributions taken from their own IRA, prior to age 59½, may incur the 10% additional tax. Keep in mind, surviving spouses that utilize an inherited IRA and then later wish to treat the inherited IRA as their own, will need to remove any hypothetical RMD payments that should have been removed from the inherited IRA before being able to move the account into their own named IRA. It is recommended to work with a tax professional with this scenario.

## Non-designated beneficiary

This category includes estates, charities, and non-qualified trusts. The options available to them are dependent on when you die — either before or on or after your RBD. If you die on or after you reach your RBD, RMDs are based on your age in the year of death and the divisor is reduced by one in each subsequent year. If you die before your RBD, the 5- year rule is followed.

**5-year rule** — Empty the Inherited IRA by December 31 of the year containing the fifth anniversary of your death.

## Other options

These distributions choices are available to most beneficiaries.

**Disclaim** — If a beneficiary does not need or want the asset, they can disclaim, or refuse, all or a portion of the assets generally, within nine months after your death. The person who disclaims is considered to have predeceased the IRA owner and cannot dictate who will inherit the assets. If the per stirpes option has been selected then the disclaimed assets will go to that beneficiary's lineal descendants, generally children. If not, then the IRA passes to any other named primary beneficiaries or, if none, then to the named contingent beneficiary(ies).

The IRA default beneficiaries may be used if there are no valid beneficiaries on file. Estates or trusts may be able to disclaim; please seek advice from your legal professional.

## The beneficiary defaults on a WFCS IRA are:

- First, a surviving spouse,
- Second, surviving children (as defined under state law),
- Third, the IRA holder's estate

**Lump-sum** — This strategy will exhaust the entire account in one distribution, with retirement assets losing their tax-advantaged status. Taxes will be due on the taxable portion of the distribution in the year received and may place the beneficiary in a higher tax bracket. Once a non-spouse beneficiary chooses to take a lump-sum distribution, it cannot be undone because contributions including 60-day IRA-to-IRA rollover contributions are not allowed in Inherited IRAs. In this situation, a spouse beneficiary would have 60 days to roll over the inherited assets into his or her own IRA, if they meet the rollover requirements.

## Talk to Wells Fargo Advisors

At Wells Fargo Advisors, we understand your desire to maximize the benefit your family receives from your retirement assets. Please investigate all the options you have in regard to beneficiary planning with your tax and legal advisors. We look forward to helping you and your family build your financial future.

## 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. If you choose to work with a financial advisor, we can 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 monitor your progress and adapt your plan as needed. Working together, we'll design and implement a retirement plan that will help you live out your unique vision of retirement.

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