



# Qtr Notes

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## RMDs for Inherited IRAs

Over the last decade, changing demographics have meant that more and more IRA accounts are being inherited by non-spouses – children, grandchildren, or other beneficiaries. These accounts have always been confusing to administer, as the rules governing required minimum distributions (RMDs) are complex and the calculations are challenging.

In 2019, the original version of the Secure Act implemented major changes to these rules that added new levels of confusion and complexity. Fortunately, the IRS stepped in and issued guidelines and clarifications in October 2022.

If you inherited an IRA from a non-spouse in 2020 or later, you are required to withdraw the entire amount within the next 10 years. If the decedent had begun taking RMDs, you will also be required to take annual minimum distributions. If you inherited an IRA before 2020, the changes do not apply to you at all.

In addition to clarifying the regulations, the IRS has also declared a unique level of relief: all penalties are waived for anyone who failed to take a distribution in 2021 or 2022 under the new rules. For IRA beneficiaries, 2023 really is starting with a clean slate.

## Inflation and Interest Rates Make for a Disappointing Year

After a decade of strong returns and three straight years of positive gains, portfolios fell in 2022 – even diversified portfolios. The S&P 500 index had its worst year since the financial crisis of 2008, and the bond market, which is normally a buffer for stocks, reported its worst year on record, due to rapidly rising inflation and interest rates.

Despite the challenges, diversified investors have fared much better than the risky portfolios of speculative investors, overly confident after several years of “easy” money. Diversified investors suffered unpleasant, but more modest, losses.

Looking back to early 2022, we see the Fed and most economists were wrong about inflation being transitory. The Fed aggressively raised interest rates throughout the year in its battle against inflation. It seems to be working; annual inflation peaked at 9% in June and ended the year at 7%, and (fingers crossed) we hope that the Fed won't have to raise rates much more.

What does the future hold for us in 2023? Early signs are that a recession is likely. The Fed is focused on fighting inflation and is willing to accept a recession as a consequence. Market strategist Ed Yardeni wrote, “Whether we call it a soft landing, a rolling recession, a growth recession, whatever . . . it will be the most widely anticipated recession of all time.”

Financial markets could quickly adjust and show resilience despite economic weakness, but we cannot gloss over the real risks to the economy over the next several months. Corporate earnings are expected to come under pressure, and declining profits could hold stock markets down until conditions improve.

It is all too easy for investors to let emotions drive their investment decisions. In June of 2022, consumer sentiment hit its lowest level on record, causing many investors to lower the risk in

| Index              | 12/31/2022 | YTD    |
|--------------------|------------|--------|
| Dow Industrials    | 33,147.25  | -8.8%  |
| S&P 500            | 3,839.50   | -19.4% |
| S&P Small-Cap      | 1,157.53   | -17.4% |
| MSCI EAFE          | 1,846.98   | -20.9% |
| Bloomberg US Bond  | 2,053.54   | -13.0% |
| US Treas 10-yr yld | 3.8%       |        |

their portfolios. History has shown us, time and again, that trying to time the markets is a costly mistake. Anything we do to reduce short-term risks requires accepting lower long-term returns.

Despite setbacks, there is much to be thankful for. Unemployment remains low. Most of us live in relative peace, with access to energy, shelter, and family. Americans were able to buy goods and services, and even with rising prices, consumer spending rose nearly 8% over last year. The worst fears of widespread calamity have been avoided.

We remain patient and optimistic about the future, focusing more on valuations and long-term returns instead of how we feel today. Asset prices are lower now than a year ago, presenting us with the potential for higher returns going forward. Crises don't last forever and portfolios will recover. It is human nature to move on and rebuild.

## The Secure Act 2.0

In 2019, the Secure Act made major changes to key aspects of retirement accounts, particularly the requirements for minimum distributions (RMDs), but the changes were confusing and many key concerns were not addressed. In December 2022, the omnibus spending bill passed by the Senate included the Secure Act 2.0, which provides clarifications, enhancements, and improvements on the original legislation. The changes will take effect over the next few years.

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## Safety In Numbers: Privacy Not Included

Every year there's a new collection of high-end tech toys. And every year, we wonder which one is the Gift That Keeps On Giving Away Your Personal Information.

Some of the potential risks seem pretty far-fetched: what if your insurance company gets hold of your DNA ancestry test and finds out you have a genetic predisposition to cancer? Others seem minor or overstated: Google Maps knows what your house looks like, but so do your neighbors. Others fall at different points of the potentially creepy scale: the newest AI-enhanced robot vacuums end up with complete floor plans of your home, your smart car knows if you left a window open, your Fitbit knows when you've been sleeping and knows when you're awake.

For every device, the essential questions are: What information does this device have? Where is that data stored? Who else has access to it, or can get access?

Fortunately, there's an excellent online guide to this fluctuating landscape: Mozilla's **Privacy Not Included** is a comprehensive guide to a huge range of devices and manufacturers. It's free to use, easy to find (just Google it), and best of all, it's written in plain simple language. The detailed reviews include tips on how to make each device as safe as possible.

## The Secure Act 2.0

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Key changes and provisions include the following:

**RMD changes.** The minimum age for RMDs, which had been raised from 70½ to 72, will increase to 73 in 2023 and to 75 in 2033.

**RMD penalties reduced.** The penalty for failing to take an RMD has been 50% of the missed amount. This will drop to 25%, and can be reduced to 10% if the error is corrected in a timely manner. In addition, to address the confusion caused by the inherited IRA provisions in the Secure Act of 2019, the IRS has extended an amnesty for all RMDs from newly inherited IRA accounts that were missed in 2021 and 2022. (See page 1 sidebar.)

**Catch-up contributions.** The catch-up IRA contribution for workers over 50, currently set at \$1,000 per year, will now be indexed to inflation. In addition, in 2025, workers aged 60-63 will be able to contribute as much as \$10,000 extra to their 401(k). Higher-earning workers must place these contributions into Roth accounts.

**Improved access to retirement plans.** Eligibility is improved for part-time workers; a special tax credit will support rapid vesting for military spouses; enrollment in "starter" 401(k) plans will be implemented for employers with no retirement plan; younger workers may receive employer contributions to 401(k) accounts matched to their student loan payments; starting in 2027, the tax credit for retirement savings will become a government contribution to a retirement account.

**College savings account rollovers.** Funds in 529 accounts that are not needed for higher education can be rolled into a Roth IRA after 15 years, subject to limitations and a lifetime cap.

**Emergency access to funds.** Starting in 2024, an emergency 401(k) withdrawal of up to \$1000 may be made without incurring the current 10% penalty, with an option to repay. Larger amounts may be withdrawn without penalty under specific circumstances, including terminal illness and federally declared disasters.

## Naming a Trust as an IRA Beneficiary

Naming beneficiaries for your IRA or 401k is one of the first estate planning decisions investors make.

The most common decision is to name a spouse, child, or other close loved one, but sometimes questions arise about naming a trust. Attorneys often recommend naming trusts as beneficiaries, but this may not be the best strategy.

The primary reason to name a trust as the beneficiary of your IRA is to maintain control over your wealth after you are gone. The primary reason to name a person instead of a trust is simplicity.

**Individual Beneficiary:** if the beneficiary is a spouse, inheritance is simple and the assets receive preferential tax treatment; the funds simply move into an IRA for the spouse. When a non-spousal individual person inherits an IRA, the assets move into an inherited IRA and are subject to different regulations. In either case, the beneficiary chooses who will inherit this account after they die, and they take distributions based on their age and marital status. Distributions will be taxed at their individual tax rate.

**Trust as Beneficiary:** if the IRA beneficiary is a trust, an inherited IRA must be opened in the name of the trust. An irrevocable trust will have its own tax ID and must file its own tax returns; in addition to the administrative and legal complexity and resulting expenses, a trust is also subject to different tax rates. Most inherited IRAs owned by trusts will face higher taxes on required distributions than would be the case if an individual inherited the IRA directly. Inherited IRAs owned by trusts may also be subject to accelerated withdrawal schedules.

What are the benefits of naming a trust as the beneficiary? A trust allows the original owner to exercise the greatest level of control over all future beneficiaries. This control may be especially valuable when there are minor beneficiaries, when it's important to keep assets within families, or when the IRA owner wishes to avoid having unwanted persons named as beneficiaries by the new owner. Lastly, a trust can provide additional creditor protection that an individual inherited IRA owner may not enjoy.

Can a trust be the right choice as the beneficiary of your IRA? The answer will always depend on your needs and circumstances, and the tradeoffs you will have to consider. Please contact us if you have questions so we can discuss your unique situation.