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Proposed Regulations for Inherited IRAs and the 10-Year Rule Bring Unexpected Clarification to Beneficiaries

Recently proposed regulations covered numerous topics, but one of the most noteworthy is an unexpected interpretation of the so-called “10-year rule” for inherited IRAs and other defined contribution plans. If finalized, these regulations could lead to larger tax bills for certain beneficiaries.

Back in late 2019, the first significant legislation addressing retirement savings since 2006 became law. The Setting Every Community Up for Retirement Enhancement (SECURE) Act resulted in many changes to retirement and estate planning strategies, but it also raised some questions. The IRS has been left to fill the gaps, most recently with the February 2022 release of proposed regulations. Many of the new provisions in the new regulations reflect the changes made to post-death IRA distributions by the SECURE Act and incorporates IRS guidance on IRA distributions issued in recent years.

Birth of the 10-Year Rule for Inherited IRAs

Before the SECURE Act was enacted, beneficiaries of inherited IRAs could stretch the Required Minimum Distributions (RMDs) on such accounts over their entire life expectancies. The stretch period could last decades for younger heirs, meaning they could take smaller distributions and defer taxes while the accounts grew.

To accelerate tax collection, the SECURE Act eliminated the rules that allowed stretch IRAs for many heirs. For IRA owners or defined contribution plan participants (“plan participants”) who die in 2020 or later, the law requires that the entire balance of the account be distributed within 10 years of death. This rule applies regardless of whether the deceased died before, on, or after the Required Beginning Date (RBD) for RMDs. Under the SECURE Act, the RBD is age 72.

Rules for Eligible Designated Beneficiaries

The SECURE Act recognizes exceptions to the 10-year rule for the following types of “Eligible Designated Beneficiaries” (EDBs):

- Surviving spouses
- Children younger than “the age of majority”
- Individuals with disabilities
- Chronically ill individuals
- Individuals who are no more than 10 years younger than the plan participant

EDBs may continue to stretch payments over their life expectancies. However, the proposed regulations provide for three unexpected exceptions to this general rule:

- Plan participant's death on or after the RBD
- Death of an EDB
- Attainment of majority by a minor child of the plan participant

Exception One: Plan participant's death on or after the RBD. If the plan participant dies before her RBD, benefits are payable to the EDB in annual installments over the EDB's life expectancy, unless the EDB elects to use the 10-year rule instead. However, the unexpected provision in the proposed regulations apply when the plan participant dies on or after the RBD. In this case, the proposed regulations indicate that annual RMDs must continue to be made after the plan participant's death over the spouse's life expectancy or decedent's life expectancy.

Exception Two: Death of an EDB. In the case of a deceased EDB, the payout based on the life expectancy of the deceased EDB continues, with annual RMDs in year one through nine after the EDB's death, and a final payout of 100% of the due in the 10th year.

Exception Three: Attainment of majority by a minor child of the plan participant. The "life expectancy payout" for minor children cannot last past 10 years after the earlier of the EDB's death or the EDB's 21st birthday.

Rules for Other Designated Beneficiaries

Under the proposed regulations, as of January 1, 2022, distributions made to other (non-eligible) designated beneficiaries can wait until the end of the of the 10-year period and take the entire account as a lump sum distribution, rather than taking annual taxable RMDs, in the case the plan participant died before her RBD.

However, if the plan participant died on or after her RBD, distributions made to the other (non-eligible) designated beneficiaries are payable annually over the decedent's life expectancy but must be distributed by the earlier of:

- (1) The year that contains the 10th anniversary of the plan participant's death or
- (2) The final year of the beneficiary's life expectancy

Clarifications of the 10-Year Rule Exceptions

The proposed regulations clarify some of the terms relevant to determining whether an heir is an EDB. For example, they define the "age of majority" as age 21 — regardless of how the term is defined under the applicable state law.

The definition of "disability" turns on the beneficiary's age. If under age 18 at the time of the deceased's death, the beneficiary must have a medically determinable physical or mental impairment that satisfies the following requirements:

- Results in marked and severe functional limitations

- Can be expected to result in death or be of long continued and indefinite duration

Beneficiaries eighteen or older are evaluated under a provision of the tax code that considers whether the individual is “unable to engage in substantial gainful activity.”

Next Steps

The regulations are proposed to be effective for 2022 RMDs. For 2021 RMDs, the IRS says that taxpayers can use a “reasonable, good faith interpretation” of the SECURE Act. How to handle 2021 RMDs might be an issue for certain beneficiaries of IRA owners and plan participants who died in 2020. Beneficiaries who missed 2021 RMDs may want to consider appropriate corrective action in the interim.

The U.S. Department of the Treasury is currently reviewing submitted comments and public hearing testimonies.

As always, though, [contact your Seiler advisor](#) at 888.454.4646 to determine the best course for your specific situation.

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