

Publications

Unsure About Secure: Proposed Regulations Significantly Change Assumptions About Administration of Inherited IRAs Following Secure Act

Related Professionals

Bailey R. Drexler
 Victor J. Ferguson
 John F. Furniss III
 Suzanne R. Galyardt
 David A. Groenke
 Michelle Shiao-Fin McIntosh
 Karen M. Moore
 Emily S. Pan
 Michael G. Schwartz

Related Services

Trusts, Estates and Wealth Transfer

AUTHORED ARTICLE | 5.4.2022

The Setting Every Community Up for Retirement Enhancement (SECURE) Act, which went into effect on January 1, 2020, made substantial changes to the law governing the administration of IRAs (including Roth IRAs) and other retirement plans (all of which are referred to in this article as IRAs), including a participant's required beginning date (the age at which an individual must start taking annual required minimum distributions (RMDs)) and the available income tax deferral available to beneficiaries of an inherited IRA.

Although practitioners and IRA beneficiaries have been working from a set of well-accepted assumptions regarding the application of the SECURE Act over the past two years, the IRS released Proposed Regulations in late February that contradicted certain major assumptions, resulting in even less favorable income tax deferral for most IRA beneficiaries.

Pre-SECURE Act: Beneficial Income Tax Deferral for Designated Beneficiaries

Option to Stretch-Out RMDs over Life Expectancy of Individual Beneficiaries.

Prior to the enactment of the SECURE Act, "designated beneficiaries," i.e., individual beneficiaries of an inherited IRA and certain qualifying trusts, were permitted to "stretch-out" RMDs based on the beneficiary's remaining life expectancy in the year following the participant's death. A surviving spouse had the option to treat the IRA as his or her own IRA or to receive a more advantageous stretch-out of the RMDs based on the surviving spouse's life expectancy, re-calculated annually.

Non-Individual Beneficiaries Subject to 5-Year Rule.

With respect non-individual beneficiaries (e.g., estates, charitable organizations, or trusts which do not qualify as a "designated beneficiaries"), such beneficiaries were not entitled stretch-out prior to

the SECURE Act. Instead, such beneficiaries were required to withdraw all of the assets in an IRA by the end of the 5th year following the year of the participant's death (the 5-year rule) (e.g., if a participant died in 2019, all assets were required to be withdrawn from the IRA by December 31, 2024).

Post-SECURE Act: Option to Stretch-Out RMDs over Life Expectancy Available Only to “Eligible” Designated Beneficiaries

While the SECURE Act did not alter the additional deferral options available to a surviving spouse, it did greatly limit the ability for most individual beneficiaries to stretch-out IRA distributions. Under the SECURE Act, only “eligible designated beneficiaries” may stretch-out IRA distributions over their respective life expectancy. This class of beneficiaries includes: (1) a surviving spouse; (2) minor children; (3) disabled or chronically ill beneficiaries; and (4) a beneficiary who is not an individual described in the preceding clauses (1) through (3) but who is not more than 10 years younger than the participant.

10-Year Rule Replaces Lifetime Stretch-Out for Most Individual Beneficiaries.

Under the SECURE Act, beneficiaries who do not qualify for “eligible designated beneficiary” treatment are subject to a deferral limit similar to – but longer than – the 5-year rule. Following the SECURE Act, non-eligible designated beneficiaries must withdraw all of the assets in an IRA by the end of the 10th year following the year of the participant's death (the 10-year rule) (e.g., if a participant dies in 2022, all assets must be withdrawn from the IRA by December 31, 2032). Thus, most beneficiaries are no longer permitted to stretch-out RMDs over their remaining lifetime. Instead, the assets in the IRA must be completely withdrawn, and the associated income tax paid, within the applicable 10-year period.

Non-Individual Beneficiaries Remain Subject to 5-Year Rule.

The 5-Year Rule applicable to non-individual beneficiaries was not changed under the SECURE Act. However, additional RMD requirements may now apply, as discussed below.

Additional Requirements Based on Application of Proposed Regulations.

The Proposed Regulations undermined one of the basic assumptions regarding the 10-year rule described above. Prior to the publication of the Proposed Regulations, the widely accepted belief was that the beneficiary was **not** required to take annual RMDs during the 10-year deferral period. Prior to passage of the SECURE Act, inherited IRAs for the benefit of non-individual beneficiaries subject to the 5-year rule were also administered in the same way – no annual RMDs were generally required to be withdrawn by the beneficiary during the 5-year deferral period.

The IRS has reached the contrary conclusion. Based on the Proposed Regulations, under both the 10-year rule and the 5-year rule, not only must all assets in the retirement plan be withdrawn by the end of the applicable period, but, **if the participant died after his or her required beginning date** (currently, April 1 of the year after the participant reaches age 72), beneficiaries must also take an annual RMD, which will typically be based on the beneficiary's remaining life expectancy – despite the fact that they are no longer permitted to stretch-out the full withdrawal of all IRA assets for such period of time.

One area where the Proposed Regulations are silent, however, is how missed annual RMDs in 2021 – when most beneficiaries were operating under the assumption that no RMD was required – will be treated or remedied.

You should strongly consider seeking legal counsel if any of the following apply to you:

- You inherited an IRA on or after January 1, 2020;
- You've named a trust as the primary or contingent beneficiary of your IRA; or
- You plan to leave a portion of your IRA to one or more minor children, an individual who may be disabled or chronically ill, or an individual who is less than 10 years younger than you.

This article gives a broad overview of the rules applicable to the majority of inherited IRAs, but there are other deferral options based on the age of the participant at death, the type of IRA (traditional v. Roth), and the identity (and sometimes age) of the beneficiary.

If you inherited an IRA prior to January 1, 2020 from which you withdraw an annual RMD, you should also contact your Vorys attorney or another advisor regarding your 2022 RMD, as the IRS table providing the applicable life expectancy for calculating your RMD has also changed.

Stay tuned for updates regarding how beneficiaries should handle missed RMDs – and potentially for more information regarding the “SECURE Act 2.0,” the “Securing a Strong Retirement Act,” which recently passed the House of Representatives. More changes may be coming for IRA participants and beneficiaries.