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IRS Regulations for Inherited IRA Distributions: What Every Beneficiary Should Know

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In May, the Internal Revenue Service (IRS) published regulations for taking Required Minimum Distributions (RMDs) from inherited IRA accounts, and we discussed these changes in this blog. Recently, the IRS provided further guidance focused on beneficiary types and categories, year of death RMDs, the 10-year rule, Trusts, and more. This blog primarily focuses on eligible designated beneficiaries.

IMPORTANT TERMINOLOGY: ARE YOU AN ELIGIBLE DESIGNATED BENEFICIARY?

Eligible designated beneficiaries include the surviving spouse, minor children, disabled individuals, chronically ill individuals, and beneficiaries less than 10 years younger than the account owner.

Note that in the majority of cases, a spousal beneficiary would opt to roll their deceased spouse's IRA into their own, rather than open an Inherited IRA for those assets. If you are a spousal beneficiary, this resource will help you determine your options when inheriting an IRA: Should I Inherit My Deceased Spouse's Traditional IRA.

UNDERSTANDING THE 10-YEAR RULE: DID REQUIRED MINIMUM DISTRIBUTIONS START FOR THE PRIOR ACCOUNT OWNER?

The 10-year rule requires that the full balance of an inherited IRA must be distributed by the end of the 10th year following the original IRA owner's death. Whether the original IRA owner died before or after their required beginning distribution date, the type of beneficiary, and age will determine if the beneficiary must take distributions during that 10-year period.

Most of the time, beneficiaries are subject to the 10-year rule if the original IRA owner died prior to beginning their RMDs, however, there are certain cases where eligible designated beneficiaries can stretch RMDs over their lifetime. Lastly, if eligible designated beneficiaries inherit an IRA account after the original IRA owner started RMDs, they can stretch distributions throughout their lifetime. Here's a great resource that will help clients determine when to take distributions

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and what type of beneficiary they are: How Must I Take Distributions From The Traditional IRA I Inherited.

It is important to note that these rules are only applicable for dates of death after December 31, 2019**.** While you are not penalized if you did not take distributions to satisfy the 10-year rule until 2025, the time clock starts the year of the original IRA owner's death.

YEAR-OF DEATH RMDS: WHAT DO YOU NEED TO DO?

If the original IRA owner dies without satisfying their RMD for the year, it must be satisfied by their beneficiaries. When individuals have more than one IRA, and the beneficiary designations on those IRAs that are not the same, the remaining year-of-death RMD must be taken proportionately from each of the Inherited IRAs based on the values at the end of the year prior to the owner's death. If the original IRA owner has taken a partial distribution prior to death, a proportional amount can be subtracted from the beneficiaries required amount.

IN CONCLUSION:

The IRS significantly altered the financial landscape for legacy planning for IRAs. While we simply highlighted the most common changes in this blog, it is important to remember that the IRS publication is well over 200 pages. It is always important to talk with your advisor and CPA when making decisions regarding Inherited IRA assets.

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