



Be prepared to take Beneficiary IRA distributions in 2023

Guest Contributor

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In 2019, The SECURE Act changed the rules concerning distributions from pre-tax Individual Retirement Accounts (IRAs) inherited through beneficiary designation (a so-called "Beneficiary IRA"). As with many such changes to the tax rules, this new rule took time to dissect and fill in "best guesses" for how the new law functioned where the statutory language was perhaps ambiguous.

It also took time for regulatory agencies like the IRS to weigh in on its interpretation of the

rule. Fast forwarding to 2023, we have a bit more clarity but still a level of uncertainty.

The specific rule at issue from the 2019 act concerned non-spouse beneficiaries of IRAs who inherited an IRA from someone that passed in 2020 or later.

Most non-spouse beneficiaries (think of your children) were required to withdraw the entire balance of the IRA within 10 years of the IRA owner's death. As one might imagine with the high prevalence of IRAs, this new rule applied to many families after the death of a loved one.

The act of 2019 appeared to suggest that the distribution requirement was simple – just withdraw the entire balance within 10 years.

Many practitioners assumed (as did this columnist) that the distributions could take place at any time up to and including distributing the entire balance the day before the 10-year deadline. Effectively this would provide up to 10 years of additional tax-deferred growth.

In the case of an account owner that passed away before he or she reached the age that triggered Required Minimum Distributions (RMDs) to begin this understanding was, and probably is, still true.

However, early in 2022, many practitioners were surprised when the IRS issued proposed regulations concerning distribution requirements for a Beneficiary IRA where the owner passed after he or she was required to begin taking RMDs.

The proposed regulations would specifically not allow the non-spouse beneficiary of an IRA to wait the (almost) 10 years before making a distribution from the IRA. Instead, the IRS proposed regulations that require the beneficiary to take out (at a minimum) a fraction of the IRA during each of the 10 years after death.

That fraction was generally the beneficiary's remaining life expectancy as the denominator and "1" as the numerator multiplied by the account balance on the previous Dec. 31.

This was the standard distribution protocol prior to the SECURE act and often referred to as the "stretch" allowing a beneficiary to take a portion out each year over the beneficiary's life expectancy.

The IRS has proposed that, because the SECURE Act did not specifically alter the annual distribution requirement, that it still remains. So, the IRS is contending (i.e. mandating) that the non-spouse beneficiary of an IRA take a fraction of the IRA for years 1-9 and take out anything remaining in year 10.

So, what's the problem? Many people who have inherited an IRA since the SECURE Act was passed have assumed that no distributions were necessary and therefore chose not to take any distributions. And, until the recent passage of SECURE 2.0 in which the penalty will be decreased, the IRS imposed a penalty when a beneficiary failed to take a RMD of 50% on the amount not withdrawn.

Luckily, the IRS was sensitive to the outpouring of comments after it issued its proposed regulations when beneficiaries realized they might be subject to that 50% tax for failure to distribute the RMDs.

In Notice 2022-53, the IRS announced that its interpretation of the RMD rule would take effect (i.e. the final regulations will apply) no earlier than the 2023 distribution year. This means that those that failed to follow the IRS proposed regulations for 2021 and 2022 are in the clear.

But, for 2023, it's time to be prepared to take the RMDs.

The exact distribution amount can be complex to calculate and depends on several variables. There are general rules and exceptions to the rules. Be sure to consult a qualified professional to discuss your specific circumstances.

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