Get Ready to Resume RMDs From Inherited IRAs in 2023

Advisors and clients should be prepared because the IRS is expected to act this year, income experts say.

By John Manganaro | January 25, 2023

After a regulatory reprieve in 2021 and 2022, the odds are that required minimum distributions from inherited individual retirement accounts will be required this year, according to two EquiTrust experts.

Speaking on a webinar held earlier this week, Heather Kane, EquiTrust vice president of sales and marketing, and Jeff Barnes, regional vice president of sales, said they expect the Internal Revenue Service to soon publish final regulations regarding the distribution requirements applying to inherited IRAs. As such, they urged financial planning professionals to study up on the substantial new restrictions placed on the use of "stretch IRAs."

According to the duo, while the use of stretch IRAs has indeed been substantially limited thanks to the passage in late 2019 of the Setting Every Community Up for Retirement Enhancement (Secure) Act, there are still key opportunities to use the strategy on behalf of certain beneficiaries. And for those who aren't eligible to stretch their inherited IRAs, there are other planning opportunities to consider.

The Regulatory Situation

In October, the Internal Revenue Service published Notice 2022-53 (https://www.irs.gov/pub/irs-drop/n-22-53.pdf?inf_contact_key=7ce72239dbfcbeeb16f04afa353ffda6), in which the agency clarified that it soon intends to publish a final regulation on the distribution of tax-sheltered assets held in inherited IRA.

The notice informed financial planners and their clients that they did not need to take distributions (https://www.thinkadvisor.com/2022/10/10/irs-new-rmd-guidance-brings-relief-to-planners-and-ira-beneficiaries-for-now/) from such inherited accounts for 2021 or 2022, regardless of whether or not the original owner had started RMDs. This essentially gave planning professionals and their clients a free pass for skipping RMDs while awaiting the final regulations .

Notice 2022-53 says the as-yet forthcoming final regulations will apply "no earlier than the 2023 distribution calendar year."

As Kane and Barnes reminded listeners, before the Secure Act, any heirs who inherited traditional IRAs could "stretch" the account's tax-deferring power by basing the calculation of their RMD amounts (https://www.thinkadvisor.com/2022/11/17/what-the-irss-2023-change-to-rmds-for-inherited-iras-means-for-clients/) on their own life expectancy. They could thus enjoy decades of tax-free asset appreciation that often would see the inherited account's value grow substantially rather than shrink, thanks to the modest RMD payments.

Under proposed IRS regulations issued earlier in 2022, most inherited IRA beneficiaries must instead fully draw down the account's value over a 10-year period, and they must take required minimum distributions in years one through nine if the account owner died after their own required beginning date.

According to Kane and Barnes, it is likely that the IRS will finalize these proposed regulations in the coming months, and that clients with inherited IRAs will indeed have to start drawing income from the accounts.

"Our understanding and what we are hearing in the marketplace is that the IRS is focused on getting this rule fully implemented this year," Kane said. "They are ready to get these assets moving out of these inherited IRAs and to collect the associated revenue."

Planning Implications for 2023

Kane and Barnes said it is important for financial advisors to start incorporating this requirement into their clients' financial plans. They also urged advisor professionals to start working now on the "intelligence gathering" that will be required to make optimal decisions with respect to inherited IRAs.

"For example, it's important to know whether or not the original owner of the IRA was drawing RMDs at the time of their death," Kane said.

Another key will be ensuring those clients who can still take advantage of the old stretch strategy know that they can do so. As stipulated in the Secure Act and the IRS' proposed regulations, there are five categories of beneficiaries who can still stretch, including the spouse of the deceased IRA owner, disabled persons, chronically ill persons, individuals who are not more than 10 years younger than the deceased owner, and minors.

Kane said this last category comes along with an important caveat: "Once the minor beneficiary ceases to be a minor in their state, they automatically convert to an ineligible beneficiary, and the 10-year rule will then apply."

While there are essentially no planning strategies that will fully make up for the loss of the stretch IRA, Kane and Barnes said there are other various other approaches to consider in 2023 and beyond. For example, the strategic purchase of annuities (https://www.thinkadvisor.com/2022/04/22/use-an-annuity-to-solve-the-stretch-ira-problem-idea-file/) can deliver substantial tax efficiency in some cases, and there are appealing opportunities to leverage charitable trusts (https://www.thinkadvisor.com/2022/12/31/does-a-charitable-trust-make-sense-for-your-client/) or donor-advised funds (https://www.thinkadvisor.com/2022/04/01/why-some-advisors-establish-donor-advised-funds-now-and-fund-later/).

(Image: Shutterstock)