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The IRS's Contradictory Interpretation of the 10-year Rule Means That Some IRA Beneficiaries Must Pivot

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On February 24, 2022, the Internal Revenue Service (IRS) issued proposed regulations relating to required minimum distributions (RMDs). These proposed regulations contradict the industry interpretation of the 10-year rule and mean that certain beneficiaries who were told that they did not have to take annual RMDs were misinformed. As a result, these beneficiaries may owe the IRS a 50% excise tax on any RMD amounts that they did not take. For advisors, this means flushing out affected beneficiaries and revising any client communications that were sent to them about the 10-year rule.

Background

The following are relevant background rules and information to consider for the purpose of this article:

1. Beneficiaries must take RMDs from inherited IRAs and employer plan accounts/benefits (*collectively referred to as IRAs for this article unless otherwise noted*). The RMD amount for a beneficiary is determined by several factors, including whether the IRA owner died before the required beginning date (RBD). The RBD is April 1 of the year that follows the year in which the IRA owner reached age 72 (70 ½ for those who reached age 70 ½ before 2020). The RBD can be deferred past this date until retirement for eligible participants with assets under employer plans.
2. For a designated beneficiary (which is a person or qualified see-through trust*) who inherited an IRA before 2020, the distribution options are as follows:

If the IRA owner died before 2020	
If the IRA owner died before the RBD	<ul style="list-style-type: none"> • The 5-year rule. Distributions are optional for the four years that follow the year in which the IRA owner died, and the account must be fully distributed by December 31st of the 5th year. Or • The life expectancy rule. Distributions are made over the single life expectancy of the designated beneficiary beginning by December 31st of the year following the year in which the IRA owner died.
If the IRA owner died on or after	<ul style="list-style-type: none"> • The life expectancy rule. Distributions are made over the longer of the designated beneficiary's single life expectancy or the decedent's remaining single life expectancy, beginning by

the RBD (N/A for Roth IRAs)

December 31st of the year following the year in which the IRA owner died.

*a beneficiary should consult with their estate planning attorney regarding whether a trust is a qualified see-through trust.

3. The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), which was enacted on December 20, 2019, changed the distribution options available to a designated beneficiary, effective for IRAs inherited after 2019.
4. The SECURE Act states that the distribution option for a designated beneficiary who inherits an IRA after 2019 is the 10-year rule, where the 10-year rule is defined by "...substituting "10 years" for "5 years" (as in the 5-year rule above), and "shall apply whether or not" the IRA owner died when RMDs were required to begin.

The IRA industry, plan administrators, and other interested parties interpreted this to mean that regardless of whether the IRA owner died before the RBD, the straight 10-year rule applied, under which distributions are optional for the nine years that follow the year in which the IRA owner died, and the account must be fully distributed by December 31st of the 10th year.

The IRS agreed in IRS Publication 590-B.

5. The purpose of the proposed regulations is to update existing regulations to reflect the amendments made by the SECURE Act.

The proposed regulations include language that requires an annual RMD for a designated beneficiary when the IRA owner dies on or after the RBD, by stating, in part, "If an employee dies on or after the required beginning date RMDs must continue at least as rapidly as under the method of distribution being used by the deceased IRA owner as of the date of his death."

Note: For beneficiaries, the Single Life Table- not the Uniform Lifetime Table which is used by owners- must be used to calculate beneficiary RMDs. Therefore, despite the "at least", in the "at least as rapidly", the beneficiary's RMD amounts will be significantly larger than the owner's RMD amounts.

As a result of these proposed regulations, the distribution options for a designated beneficiary who inherits an IRA after 2019 are as follows:

	If the IRA owner died after 2019
If the IRA owner died before the RBD	<ul style="list-style-type: none">• The 10-year rule. Distributions are optional for the nine years that follow the year in which the IRA owner died, and the account must be fully distributed by December 31st of the 10th year.
If the IRA owner died on/after the RBD (N/A for Roth IRAs)	<ul style="list-style-type: none">• The life expectancy rule. Distributions are made over the single life expectancy of the designated beneficiary beginning by December 31st of the year following the year in which the IRA owner died. And• Distributions cannot extend beyond the end of the 10th year that follows the year in which the IRA owner died.

The Potential Fall-Out of the Contradictory Interpretation and the Solution

Until the proposed regulations were published, the generally accepted interpretation was that a designated beneficiary who inherited an IRA after 2019 had no RMD obligations for the first nine years after the owner's death. But as explained above, this is true only if the IRA owner died before the RBD. It is also true for a Roth IRA

regardless of the age at which the Roth IRA owner dies. Roth IRA owners are not subject to RMDs and therefore there is no RBD for Roth IRA owners.

As established above, those who inherited IRAs from owners who died on or after the RBD are required to take annual RMDs and might not have done so because of this misinterpretation. While this can be corrected going forward, those who inherited IRAs in 2020 might not have taken RMDs that should have been taken in 2021. Even though a 50% excise tax is owed on these RMD shortfalls, tax preparers may request a waiver of this excise tax by filing [*IRS Form 5329, Additional Taxes on Qualified Plans \(including IRAs\) and Other Tax-Favored Accounts*](#). (Form 5329). The excise tax is addressed in *Part IX—Additional Tax on Excess Accumulation in Qualified Retirement Plans (Including IRAs)*.

Should We Operate under This Interpretation?

A question often asked by interested parties is whether we are required to operate under these proposed regulations since they are only 'proposed.'

Proposed regulations can be withdrawn or modified. Further, these proposed regulations provide that they apply to RMDs for calendar years beginning on or after January 1, 2022; and, for the 2021 distribution calendar year, "...taxpayers must apply the existing regulations, but taking into account a reasonable, good faith interpretation of the amendments made by ... the SECURE Act". It goes on to say that taxpayers who operate in compliance with these proposed regulations will satisfy that requirement.

Considering the reasoning in the proposed regulations regarding this annual RMD requirement for designated beneficiaries who inherit IRAs from owners who died on or after the RBD, a safe path for avoiding the 50% excise tax is to take annual RMDs. Those who choose to wait can take comfort in the fact that the IRS will waive the penalty where the deadline is missed due to 'reasonable cause'- and this confusion is definitely 'reasonable cause.' Beneficiaries should consult with their tax advisors regarding their next steps.

Action Plan for Advisors

Advisors should revise any communication to their target audience regarding this new interpretation and help affected clients take corrective steps. A practical approach is to:

- Identify clients with inherited IRAs.
- Send a client letter to these beneficiaries explaining this interpretation. Given the ado made of this interpretation in the financial media, it is practical to send this to all clients with inherited IRAs so that it is clear who is affected and who is not.

The good news is that the pool of clients who might be adversely affected is small, as it is limited to designated beneficiaries of traditional IRA owners and all plan participants who died in 2020- including those with designated Roth accounts- and where their deaths occurred on or after their RBD. Those who inherit IRAs in 2021 and after will have time to take RMDs by the applicable deadlines.

This interpretation should not affect non-designated and eligible designated beneficiaries, since it was already clear that they must take annual beneficiary RMDs from IRAs inherited from owners who died on or after their RBDs

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