

RMD quirks that IRA beneficiaries face in '23

The provisions of the SECURE and CARES Acts, and the related IRS rules, are creating even more confusion about which beneficiaries are subject to RMDs this year.

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The calculation of required minimum distributions for beneficiaries has always been uniquely complicated because of confusing tax rules that differ depending on the type of beneficiary, when they inherited, and whom they inherited from.

Now the provisions of the **SECURE** and CARES Acts, and the related IRS rules and relief provisions, are creating even more confusion about which beneficiaries are subject to RMDs for 2023 and how much they need to withdraw.

Advisors can navigate this much more easily by knowing which type of beneficiary inherited, and by answering two questions:

When did the IRA owner die? Before 2020, or in 2020 or later when the SECURE Act rules became effective, eliminating the stretch IRA for most beneficiaries?

Whether the IRA owner died before or after his or her RMD required beginning date? The RBD is generally April 1 of the year following the year the IRA owner turned 72

INHERITANCE BEFORE THE SECURE ACT (BEFORE 2020)

Let's start with the "when": Did the beneficiary inherit before 2020?

If yes, then the SECURE Act rules do not apply. If the beneficiary is a "designated beneficiary," he or she can continue the stretch IRA, taking RMDs based on his or her single life expectancy. Designated beneficiaries are individuals (rather than a nonperson, like an estate, charity, or nonqualifying trust) named on the beneficiary form. The common example is an adult child who inherits the IRA of a parent.

WHETHER OR WHEN

Designated beneficiaries are grandfathered under the pre-SECURE Act rules. However, since these beneficiaries inherited before 2020, they had to reset their stretch IRA RMD

schedule in 2022 to the current IRS Single Life Table. This resulted in slightly lower RMDs.

In this case, we don't have to answer the "whether" as long as the beneficiary is a designated beneficiary. The "whether" only matters if the beneficiary is not a designated beneficiary.

Example 1: Designated beneficiary — only the "when" matters. Jim inherited an IRA from his mom, Ann, in 2017, at age 40. He was named on the IRA beneficiary form, so he's a designated beneficiary and qualifies for the stretch IRA. Since he's a designated beneficiary and inherited before 2020 (the "when"), the SECURE Act changes don't impact his RMD schedule.

Jim began taking RMDs on the inherited IRA in 2018, the year after death, when he was 41. His RMDs were based on the old Single Life Table. His life expectancy factor was 42.7 years for 2018. In 2019 and succeeding years he would reduce that factor by one year.

But for the 2022 RMD, Jim had to reset his life expectancy factor to the new and more favorable Single Life Table. He would reset by starting with what his life expectancy would have been in 2018 under the new table (44.8 years for a 41-year-old) and then subtracting one for each year up to 2022 (44.8 less the 4 years = 40.8 years). For his 2023 RMD, Jim will subtract one from the 2022 RMD to produce a 39.8 life expectancy.

The CARES Act waived all RMDs for 2020, but that has no impact on the RMD calculation.

If Jim's IRA balance on Dec. 31, 2022, is \$300,000, then his 2023 RMD will be \$7,538 ($\$300,000/39.8 = \$7,538$).

Since Jim is a designated beneficiary and he inherited before the SECURE Act was effective, the "whether" doesn't matter to him. It makes no difference here whether Jim's mom died before or after her RMDs began. Her age doesn't matter.

Example 2: Nondesignated beneficiary — only the "whether" matters. If the beneficiary of Ann's IRA wasn't a designated beneficiary (say, her estate), then the "when" wouldn't matter because the SECURE Act didn't change the beneficiary RMD rules for nondesignated beneficiaries. But the "whether" would matter.

Under the RMD rules for nondesignated beneficiaries, if death occurred before the deceased IRA owner's RBD, then the 5-year payment rule would apply. This means all the inherited funds would have to be withdrawn by the end of the fifth year after the owner's death (2020 does not count since the CARES Act waived RMDs for this year).

However, if death occurred on or after the RBD, then the so-called "ghost rule" would apply. This requires the beneficiary to take RMDs based on the owner's remaining

single life had he or she lived. In this case, the age of the deceased IRA owner would matter since the post-death RMDs would be based on his or her remaining life expectancy.

INHERITANCE AFTER THE SECURE ACT (AFTER 2019)

If the beneficiary inherits after the SECURE Act, and the beneficiary is a designated beneficiary but not an eligible designated beneficiary, then the “whether” also matters.

ELIGIBLE DESIGNATED BENEFICIARIES

EDBs are a **special category of beneficiaries** created by the SECURE Act where the stretch IRA rules still apply. So the “whether” doesn’t matter to this category. Other than maybe some technical fine points, IRS final regulations will probably not bring many changes to RMDs for this group. As a review, EDBs must first be designated beneficiaries: individuals (or qualifying trusts) named on the IRA or plan beneficiary form.

5 CLASSES OF EDBs

1. Surviving spouses
2. Minor children of the account owner, until age 21 — but not grandchildren
3. Disabled individuals — under the strict IRS rules
4. Chronically ill individuals
5. Individuals not more than 10 years younger than the IRA owner (or beneficiaries who are older than the IRA owner); plus, any designated beneficiary (including qualifying trusts) who inherited before 2020.

These beneficiaries are grandfathered under the pre-2020 stretch IRA rules. In addition, conduit trusts for the sole benefit of these EDBs can qualify as an EDB under the IRS proposed regulations.

EDB status is determined as of the date of the account owner’s death and cannot be changed.

Example 3: Non-EDB designated beneficiary — both the “when” and the “whether” matter. Pam inherited an IRA from her mom in 2020, at age 40. She’s a designated beneficiary, but not an EDB. But since she inherited after the SECURE Act was effective (the “when”), she doesn’t qualify for the stretch IRA. She will be subject to the 10-year rule and she must empty the inherited IRA by the end of the 10th year after death (by Dec. 31, 2030).

Since Pam is subject to the SECURE Act rules and the related IRA proposed regulations from 2022, we must also ask the “whether” question: Did her mom die before or after her RBD? If mom died before her RBD, say at age 68, then Pam isn’t subject to any RMDs in years one through nine of the 10-year term. The only RMD is at the end of the 10th year when the entire balance must be withdrawn.

However, it gets trickier if her mom died on or after her RBD. In that case, RMDs must be taken for years one through nine of the 10-year term based on Pam's single life expectancy. The first year RMD for the year after death (2021) would be based on the 42.7-year factor under the old IRS Single Life Table, the 2022 RMD factor would be 43.8 years under the new table (after reset), and Pam's 2023 RMD factor would be 42.8 years. Complicating matters further for advisors is the issue of the 2021 and 2022 RMDs, where death occurred after RMDs had begun (after the RBD).

Due to the confusion over the rules, IRS issued Notice 2022-53 back in October providing RMD relief by waiving the excise tax (the 50% RMD penalty) for missed 2021 and 2022 inherited retirement account RMDs for beneficiaries subject to the SECURE Act 10-year payout rule. The result was that the RMDs for 2021 and 2022 in this situation did not have to be taken.

However, that relief has no impact on the calculation of the 2023 RMD. In the Pam example above, the factor for 2023 remains at 42.8 years whether 2021 and 2022 RMDs were taken or not. The IRS relief also does not change the 10-year term. It still ends Dec. 31, 2030.

These will be the IRA beneficiary RMD rules for 2023, until IRS issues final regulations, which should happen this year. The final regulations will likely leave these rules in place.

If IRS does make any changes, hopefully they will be early enough in the year to get the word out to clients, or not take effect until 2024.