Updated IRS Guidance on Inherited IRAs

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The SECURE Act of 2019 introduced substantial changes to the rules governing inherited IRAs. These changes aimed to simplify the retirement system and expand access to retirement plans. However, they also brought about new complexities, especially concerning required minimum distributions (RMDs) for inherited IRA beneficiaries.

The 10-Year Rule

Under the new rules, non-designated beneficiaries must deplete the inherited IRA within ten years of the account holder's death. This 10-year rule replaces the previous "stretch IRA" provisions, which allowed beneficiaries to take distributions over their lifetime, thereby extending the tax-deferred growth period.

Exceptions to the 10-Year Rule:

Certain beneficiaries, known as Eligible Designated Beneficiaries (EDBs), are exempt from the 10-year rule and can still stretch distributions over their lifetime. EDBs include:

- Surviving spouses
- Minor children of the account owner (until they reach the age of majority)
- Disabled or chronically ill individuals
- Individuals not more than ten years younger than the deceased account owner

Key Changes in the IRS Guidance Regarding RMDs

Since the change went into effect in 2020, there has been confusion regarding RMDs. The IRS issued guidance in July of 2024 clarifying that non-designated beneficiaries are required to take annual RMDs throughout the 10 years[1]. The IRS is waiving any penalties for beneficiaries who have not taken an RMD prior to 2025. While no penalties will be assessed for RMDs not taken in years 2020-2024, the account still must be depleted within 10 years. This means, for account holders who passed away in 2020, non-designated beneficiaries must deplete the account by 2031.

Strategic Planning Opportunities

The 10-year rule may accelerate the timeline for tax liabilities, especially if significant assets are involved. Some beneficiaries may benefit by taking larger RMDs in lower tax years or by making larger withdrawals before income tax rates are set to increase in 2026 with the sunset of the 2017 Tax Cuts and Jobs Act. Strategic planning can help mitigate the tax impact, so we recommend reviewing your situation with a tax advisor.

Individuals who have named trusts as IRA beneficiaries may need to revisit their estate plans. The new rules can complicate trust structures designed to extend distributions. Ensuring that trusts are properly drafted to comply with the new regulations is essential. We recommend consulting with your estate attorney.

Roth IRA conversions can be a powerful tool under the new rules. While Roth IRAs are still subject to the 10-year rule for non-designated beneficiaries, the distributions are tax-free, which can be advantageous, especially for heirs in higher tax brackets. Individuals with large retirement account balances may consider converting these tax-deferred funds to Roth accounts during their lifetime before passing them to the next generation.

Clients who are charitably inclined may consider naming a charity as the beneficiary of their IRA. This strategy can eliminate the income tax on IRA distributions, providing full value to the charity and reducing the taxable estate.

The updated IRS guidance on inherited IRAs underscores the importance of proactive planning. By understanding the new rules and implementing strategic measures, you can navigate these changes effectively. If you need personalized advice, please reach out to our planning team.

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[1] https://www.irs.gov/pub/irs-drop/n-24-35.pdf

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