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COMMENTARY

Update for Inherited IRAs: Final Regulations Are Here

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Trusts and Estates

By Rebecca Rosenberger Smolen and Amy Neifeld Shkedy | August 30, 2024 at 11:42 AM

Since the SECURE Act was passed in December 2019, taxpayers have been awaiting final word on how to interpret the new 10-year rule that pertains to required minimum distributions (RMDs) from an inherited IRA account attributable to a decedent who had been required to take minimum distributions at the time of death. This relates to situations where death occurred after the decedent's "required beginning date" or "RBD." The verdict is finally in.

Many commentators fervently asserted that the correct statutory interpretation of the post-RBD 10-year rule was that no distributions should be required until the end of the 10-year period. However, the IRS issued proposed regulations in February 2022 indicating that, to the contrary, annual distributions would be required in each of the 10 years. Due to the uncertainty as to which approach would be adopted under the final regulations, the IRS has annually waived any distribution requirement for taxpayers subject to the post-RBD 10-year rule, including for 2024.

However, starting in 2025, under the final regulations just issued by the IRS in July, the views of the commentators advocating a more taxpayer friendly statutory interpretation have been disregarded, and annual distributions will now be required, based on the longer of the life expectancy of the beneficiary or the decedent (as though still living, so sometimes referred to as a "ghost" life expectancy).

It is important to note that the pre-RBD 10-year rule is different: if the 10-year rule applies to an inherited IRA account attributable to a decedent who was not yet required to take distributions, then distributions may be deferred until the end of the 10-year period. That payout rule was never in controversy. And, as further backdrop, the typical RBD has been in flux under recent changes in the law—for most taxpayers the RBD is April 1 of the year after they have reached a certain age ranging from 70.5 to 75, depending on their year of birth.

Here are some other noteworthy matters that have been addressed by these final regulations:

Minor Children as Beneficiaries: For accounts where multiple children under 21 are beneficiaries, there is a favorable rule which allows the 10-year distribution period to commence after the youngest child reaches age 21. Under the proposed regulations, that period would have commenced after the oldest child reached age 21.

Separate Shares for Subtrusts: When a trust is named as beneficiary, oftentimes there will be subtrusts for different beneficiaries that will ultimately be funded under the trust instrument. There are times when it is beneficial to treat the subtrusts as separate designated beneficiaries, with separate shares, for the purposes of the RMD rules. Under the old rules, for that to be possible, the subtrusts needed to be specifically named in a beneficiary designation form. Now, as long as the governing trust instrument requires that the IRA be distributed in predetermined shares to the separate trusts as of the date of the decedent's death, the subtrusts can each be treated as separate designated beneficiaries of the IRA with separate shares of the inherited IRA. As a drafting matter, this means that the trustee cannot be empowered to shift the interests of the subtrusts in the inherited IRA through a "pick and choose" funding decision.

Older Beneficiaries: Under the proposed regulations, if a beneficiary was older than the decedent, the shorter life expectancy of the beneficiary would determine the payout period. However, the final regulations created a more favorable approach allowing the older beneficiary to use the longer payout period attributable to the "ghost" life expectancy of the decedent.

For readers who are interested in a broader overview of the post death RMD rules, we had previously covered that topic in a column in the Legal back in October 2014, and revisited the topic in several other columns, including in October 2022 and January of 2020 (after the SECURE Act came on the scene).

As a final comment, while the RMD rules for inherited IRAs have been in constant flux over the last few decades, overall they have gotten simpler. Yet, we are finding that the claim forms issued by financial institutions have been getting more complicated. Although the calculation of the RMD each year is the responsibility of the taxpayers, the financial institutions seem ready to assist in the process and the forms are seeking information to help them to do that.

However, in our recent experience, at least with respect to trusts as beneficiaries, some of the forms are seeking some information prematurely to open accounts in the weeks after a decedent's death, when the information is not required to be provided until a later date under applicable IRS rules. Moreover, much of the information sought, such as the characterization of a trust as a "conduit," "accumulation" or "see-through" entity invokes concepts that the average taxpayer as a layperson cannot easily understand—even with a Google search.

For example, a trust certification isn't due until Oct. 31 of the year after the year of death, so it should be optional, and not required, to be provided to open an account far in advance of that date. Also, the beneficiary determination date isn't until Sept. 30 of the year after the year of death. These "deadlines" are developed because things can change, by design or circumstance, between the date of death of the decedent and the deadline for the first post death RMD for the beneficiary on Dec. 31 of the following year. While many times nothing will end up changing, in many unforeseen instances it will, and to preserve options and avoid confusion down the road, it will typically be better to hold off certifying anything to the financial institution until the dust has become more settled.

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