

April 22, 2024 – Wealth Planning Commentary

The IRS Waives Required Distributions for IRAs Inherited After 2020

For the fourth year in a row, the IRS has waived the mandatory Required Minimum Distributions (RMD) for IRAs that were inherited after 2020. The Secure Act of 2020 eliminated the favorable stretch IRA for non-eligible beneficiaries. A non-eligible beneficiary is everyone except the surviving spouse, disabled individuals, and minor children. Any IRA inherited after 2020 by a non-eligible beneficiary is subject to the 10-year rule. This rule states that the account must be depleted by the tenth year following the original owner's death. However, the language in the act is unclear on whether a non-eligible beneficiary is subject to RMD during the ten years before mandatory depletion.

The IRS has threatened to clarify this RMD issue for some time. When and if the IRS rule is implemented, it's believed that only IRAs in their RMD phase before the owner's death are subject to the rule. The only concrete guidance the IRS gives is that the RMDs are not required this or past years, and any potential penalties are waived.

In short: if someone inherited an IRA before 2020, continue taking RMDs as before. If the IRA was inherited after 2020, and the **beneficiary** is not a spouse, disabled person or minor, deplete the account by the tenth year. After 2020, if the beneficiary is the surviving spouse, the stretch rule applies. There are similar favorable rules for disabled persons and minors.

If and when IRAs that are subject to the 10-year rule are required to take RMDs, high-income earners are impacted the most. On the federal level, distributions are taxed at the 35% or 37% marginal bracket. Residents in states like New York or California are also taxed at high rates on the state level.

Even though RMDs do not apply this year for IRAs subject to the ten-year rule, it doesn't mean a beneficiary shouldn't take distributions. It depends on one's specific financial situation. For instance, if it's a low-income year, one might consider taking a distribution to minimize taxes during the full 10-year depletion period. Those who are in low marginal income tax brackets, especially those who are under the Roth AGI phaseout, can take an RMD and then contribute those funds to a Roth IRA.

Inheritors of large IRAs are in a tight spot. Taking the remaining balance out in the tenth year may expose much of the distribution to higher tax rates. Consider smoothing out the withdrawals by distributing an amount each year over the ten years. A strategy for high earners is to minimize their income in the tenth year. Take a sabbatical or quit a job in the year of the large distribution.

Please reach out to your Wealth Manager with questions about inherited IRA distributions.

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