IRA distribution options for beneficiaries

Wealth Management

The distribution options as a beneficiary of an IRA or Roth IRA depend on a number of factors: the type and status of the beneficiary, when the original account owner passed away and what age the original owner attained prior to passing.

Required beginning date (RBD)

The RBD is the date that an IRA owner must begin taking required minimum distributions (RMDs)—specifically, April 1 of the calendar year following the calendar year in which an account owner reaches age 73.

Designated beneficiary

A designated beneficiary is the individual whose life expectancy is used to calculate RMDs (if applicable) after the death of an IRA owner. Beneficiary designations, for distribution purposes, do not become fixed until September 30 of the year following the year of an IRA owner's death. This is referred to as the beneficiary designation date.

No new beneficiaries can be named after the death of an IRA owner. But beneficiaries who disclaim or have had their benefits paid out to them in full prior to this date will not be considered when determining death distribution options.

A beneficiary can disclaim all or a portion of their inherited IRA benefit. By disclaiming, the beneficiary is giving up rights to the assets, which then pass to the other beneficiaries. A valid disclaimer must meet specific requirements and generally must be executed within nine months of the IRA owner's death.

Date of death

The distribution options available to non-spouse designated beneficiaries depend on the date of death of the original IRA owner. If the owner passed away prior to January 1, 2020 (pre-SECURE Act), the beneficiary may have the option to stretch the IRA. This allows the beneficiary to transfer the remaining assets to their own beneficiary IRA and to take required minimum distributions based on their remaining single declining life expectancy. The beneficiary's single declining life expectancy is calculated utilizing the Single Life Table (IRS Table I) based on the beneficiary's age in the year following death. In each subsequent year, the factor is reduced by 1.0.

If the owner passed away on or after January 1, 2020 (post-SECURE Act) and a non-spouse designated beneficiary was named, the beneficiary would generally be subject to the SECURE Act's 10-year rule, which in most cases will additionally require annual RMDs during that same 10-year period, provided the original IRA owner died post-RBD.

Eligible designated beneficiaries

The passage of the SECURE Act created a new class of beneficiaries termed eligible designated beneficiaries (EDBs) who are generally not subject to the SECURE Act's 10-year rules. EDB distribution options generally mirror the rules available to pre-SECURE Act designated beneficiaries, where annual RMDs would be satisfied based on the beneficiary's single declining life expectancy where no 10-year rule applies.

Eligible designated beneficiaries include

- Surviving spouses
- Minor children of the decedent but only until the age of majority (age 21)
- IRS-defined disabled or chronically ill individuals
- Individuals who are not more than 10 years younger than the original IRA owner or are older than the original IRA owner

Required distribution rules for inherited IRAs

If you are the designated beneficiary of a pre-SECURE Act deceased IRA owner or an eligible designated beneficiary, you can still stretch the RMDs over your remaining single declining life expectancy rather than being subject to the SECURE Act's new 10-year rule.

Distributions you take as a beneficiary are generally taxable as ordinary income but are exempt from the 10% premature distribution penalty—regardless of your age.

If you are not a designated beneficiary of a pre-SECURE Act death or an EDB of a post-SECURE Act death, your distribution rules are dependent upon the decedent's age at death, namely, either pre-RBD or post-RBD.

For pre-RBD client death scenarios: If a designated beneficiary is not considered an EDB, they will be subject to the SECURE Act's 10-year rule, where annual distributions are not required. The SECURE Act's 10-year rule stipulates that the beneficiary IRA account must be fully withdrawn within 10 years and by no later than December 31 of the 10th year following the year in which the original IRA owner died.

For post-RBD client death scenarios: If a non-spouse designated beneficiary is named as the beneficiary and is not considered an EDB, they will be subject to the SECURE Act's 10-year rule, where annual required minimum distributions are required based on the beneficiary's actuarial single declining life expectancy (employing IRS Table I). In addition, all assets must be withdrawn by no later than December 31 of the 10th year following the year in which the original IRA owner died.

Roth IRA beneficiaries

There is no required beginning date for Roth IRAs because a Roth IRA owner isn't required to take RMDs during his or her lifetime. A Roth IRA is not subject to a required distribution period until a non-spouse beneficiary inherits the assets. When a non-spouse designated beneficiary inherits Roth IRA assets, they are subject to the SECURE Act's 10-year rule, where annual distributions are not required. The SECURE Act's 10-year rule stipulates that the inherited or Roth IRA must be outright distributed by no later than December 31 of the 10th year following the year in which the original IRA owner died.

In the event the named Roth IRA beneficiary qualifies as an EDB, they will not be subject to the SECURE Act's 10-year rule but would be subject to pre-SECURE Act stretch rules where annual RMDs would be required based on the beneficiary's single declining life expectancy (IRS Table I).

Penalty leniency on missed RMDs

On December 29, 2022, as part of the Consolidated Appropriations Act of 2023 (P.L. 117-328), President Joe Biden signed the SECURE 2.0 Act into law.

Section 302 of the SECURE 2.0 Act (effective 2023) created new rules related to the penalties for missed RMDs. Previously, any missed RMD was subject to 50% excise penalty. The SECURE 2.0 Act modifies these rules by reducing the penalty for missed RMDs to 25% and further reduces to 10% if the missed RMD is corrected between January 1 of the year following the year of the missed RMD and upon the earliest of the following dates:

- When the notice of deficiency is mailed to the client
- When the tax is assessed by the IRS
- The last day of the second tax year after the tax is imposed

Successor beneficiaries

Upon inheriting an IRA, you can name successor beneficiaries. If you die before the assets are fully distributed, your successor beneficiaries may take a lump sum distribution of the remaining assets if they so desire. Otherwise, the successor beneficiaries of the original beneficiary are generally subject to the 10-year rule.

Successor beneficiaries of a pre-SECURE Act beneficiary are generally subject to the SECURE Act's 10-year rule. However, since the first pre-SECURE Act beneficiary was subject to annual RMDs, the successor beneficiary will also be subject to RMDs during this 10-year period. The RMD requirements during this new 10-year period will continue to be based on the first beneficiary's life expectancy.

Note: If the original beneficiary also died before 2020 (pre-SECURE Act) the successor beneficiary may continue taking RMDs according to the schedule of the remaining single declining life expectancy of the first beneficiary.

Successor beneficiaries of a post-SECURE Act beneficiary, where the 10-year rule applied to the first inheritor will require the successor beneficiary to "step into the shoes" of the original beneficiary's 10-year window. If the first beneficiary inherited assets from a post-RBD decedent, where annual RMDs are required during the 10-year period, the successor beneficiary will continue to utilize the life expectancy of the first beneficiary. The annual RMDs during the remainder of the first inheritor's 10-year period does not recalculate to the successor beneficiary's life expectancy.

Trust

Generally, only living individuals can be designated beneficiaries. However, even though a trust is a non-living entity, a special rule may be applied to certain trusts—notably, special needs or supplemental needs trusts, which are trusts established for the benefit of either a disabled individual, as defined under Tax Code Section 72(m) (7) or a chronically ill individual, as defined under Tax Code Section 7702B(c)(2).

Under this rule, the special needs individual who is the trust beneficiary will be treated as the eligible designated beneficiary and be permitted to stretch RMDs over their own single declining life expectancy; calculation based on the IRS Single Life Table (Table I). The following regulatory requirements must be met to also create a valid look-through trust:

- The trust is valid under state law and is irrevocable or will, by its terms, become irrevocable upon the death of the IRA owner
- The trust beneficiaries must be individuals clearly identifiable (from the trust document) as designated beneficiaries as of September 30 of the year following the year of the IRA owner's death
- The IRA custodian is provided with a list of beneficiaries (including contingent remainder beneficiaries) along with a written certification that the list is accurate and the trust is a valid look-through trust by meeting the above requirements by October 31 of the year following the year of the IRA owner's death
- A copy of the trust instrument is provided to the IRA custodian upon demand

Additional guidance from the IRS/Department of the Treasury is still needed to determine whether or to what extent trusts named as beneficiaries of IRAs may also be permitted to allow an EDB of a trust to stretch RMDs over their own remaining single declining life expectancy (see IRS Table I)[1]. In this regard, eligible designated beneficiaries may also potentially include a surviving spouse, a minor-aged child of the deceased IRA owner but only until the age of majority (age 21), and an individual who is not greater than 10 years younger than the original IRA owner.

Beneficiaries of qualified plan assets

A spouse beneficiary can generally roll over death benefits inherited from a qualified retirement plan, such as a 401(k), pension or profit-sharing plan, into their own IRA. Keep in mind that if the plan participant was past their RBD when they passed away, their current year RMD must be distributed to their beneficiary(ies) and is not eligible to be rolled over.

In the case of a non-spouse beneficiary that is a living person, or a qualifying look-through trust, they can roll over their inheritance into a beneficiary IRA. The rollover must be done via a direct rollover—no 60-day rollovers are permitted. The beneficiary IRA must be a traditional IRA (unless you inherit designated Roth 401(k) account or designated Roth 403(b) account assets) and will be subject to the required distribution rules applicable to a non-spouse beneficiary.

The ability to do the direct rollover is significant because qualified plans often require faster payouts to non-spouse beneficiaries than the law requires, thus accelerating taxation. For a non-spouse beneficiary to take advantage of utilizing their own life expectancy (if applicable) it is important that the direct rollover occur in a timely manner, generally by December 31 of the year following the year of the plan participant's death. If you inherit qualified plan assets, your first step should be to consult the administrator of the qualified plan regarding your post-death options as a beneficiary.

Making important decisions

Making a decision regarding a retirement plan inheritance can seem very overwhelming in the midst of losing a loved one. Your financial advisor, along with your tax or legal advisor, can walk you through each of the above options and help you make the decision that best fits your needs.

Beneficiary distribution options for deaths that occur on or after January 1, 2020

Beneficiary distribution options		
	Beneficiary	**Distribution options**
Death before required beginning date	Spouse	1. Transfer or rollover to own IRA • Lump sum distribution • RMDs over their life expectancy beginning at 73 2. Distribute assets over their life expectancy in inherited IRA structure • Distributions are required to begin by December 31 of the year following the year the decedent account owner would reach age 73 • Distributions are based on the life expectancy of the surviving spouse utilizing the Single Life table (IRS Table I) • No 10% penalty for distributions from inherited IRA structure 3. Follow the 10-year rule in inherited IRA structure
	Non-spouse designated beneficiary	All assets must be distributed by December 31 of the 10th year following the year of the original account owner's death, where no annual RMD is required.
	Eligible designated beneficiary	1. Annual RMDs based on the beneficiary's single declining life expectancy (IRS Table I) 2. Follow the 10-year rule, where no annual RMD is required.
	Non-spouse—no designated beneficiary	The full balance of the account must be distributed by December 31 of the fifth year following the year of the original account owner's death.
Death after required beginning date[2]	Spouse	1. Transfer or rollover to own IRA • Lump sum distribution • RMDs over their life expectancy beginning at 73 2. Distribute assets in inherited IRA structure • Distributions may be based on the greater of: the single declining life expectancy of the surviving spouse (IRS Table I) or the single declining life expectancy of the deceased IRA owner (IRS Table I) • No 10% penalty for distributions from inherited IRA structure
	Non-spouse designated beneficiary	All assets must be distributed by December 31 of the 10th year following the year of the original account owner's death while additionally satisfying annual RMDs generally based on the beneficiary's single declining life expectancy (see IRS Table I).
	Eligible designated beneficiary	Annual RMDs based on the longer of the beneficiary's single declining life expectancy (IRS Table I) or the decedent's single declining life expectancy (IRS Table I).
	Non-spouse—no designated beneficiary (Charity, estate, or non-look-through trust)	All assets must be distributed based on the remaining single declining life expectancy of the deceased IRA owner commencing in their year of death.

1. Trust must be administered as "conduit" trust to allow for stretch distributions based on single declining life expectancy (IRS Table I).
2. If an account owner dies after their RBD but prior to satisfying their current year RMD, their beneficiaries must satisfy the current year RMD.

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