

# Inherited IRAs: A New Era Begins

2024 will see updated rules kick in, including an end to the 'stretch IRA.'

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New rules for inherited individual retirement accounts (IRAs) were passed by Congress as part of the original SECURE Act in late 2019, but have yet to be fully enacted due to pandemic-related disruptions. However, the IRS is poised to finalize these new rules for 2024 and beyond, so we thought it was time for a detailed review of

new rules surrounding inherited IRAs.

Below we cover how IRAs are treated when you inherit from a spouse, as well as from a non-spouse, and discuss some of the financial planning implications of the new rule.

## REQUIRED MINIMUM DISTRIBUTIONS (RMDs)

When you reach age 73, you're generally required to begin drawing money from your retirement accounts each year.

There are two primary exceptions to this rule. First, Roth IRA accounts don't have required minimum distributions (RMDs) during the lifetime of the account holder. Second, in a company retirement plan, where you're still working, and aren't an owner of 5% or more of the company, you can postpone distributions until you leave the company.

Note that your RMD must be fulfilled in the year you die. If the distribution had not been completed at the time of death, it's the obligation of your beneficiaries to take a distribution by year-end. It's in the following year that things get complicated.

## IRAS INHERITED FROM A SPOUSE

If you inherit an IRA from your spouse, you have an opportunity that other beneficiaries don't have. As a spouse, you can roll the account over into an IRA in your name — either an existing IRA or a newly created one. Thereafter, you then follow the RMD rules that apply to your own retirement accounts, based on your own age.

## WHAT IF YOU INHERIT AN IRA FROM SOMEONE OTHER THAN YOUR SPOUSE?

If you inherit an IRA from someone other than your spouse, you don't have the option of rolling the IRA into your own name. Instead, a new beneficiary IRA account must be opened, sometimes referred to as a beneficiary distribution account (BDA). The new account title should include the original owner's name and the owner's date of death as well as your name. The exact format for the title

may vary from one IRA custodian to another.

Prior to 2019, when you inherited an IRA from a non-spouse, you were required to start taking distributions in the year following the death of the owner, based on your own age and the Internal Revenue Service tables, which meant you had the ability to stretch the IRA out over your lifetime.

The SECURE Act changed this by creating new distribution rules and a new framework for classifying beneficiaries that eliminated the "stretch IRA" for the majority of non-spouse beneficiaries. In 2024 and beyond, most non-spouse beneficiaries will be required to distribute the entire account within 10 years of the original owner's death. The mechanics and timeline of these distributions differ depending on which of three new beneficiary groups you qualify for, as listed below.

## NEW BENEFICIARY GROUPS

The SECURE Act created three separate beneficiary groups, each with its own rules:

- **Non-designated beneficiaries** — entities such as trusts or charities.
- **Eligible designated beneficiaries** — individuals who fall into one of five categories:
  1. Spouse of the deceased IRA owner;
  2. A disabled individual;
  3. A chronically ill person ;
  4. A person not more than 10 years younger than the deceased IRA owner;
  5. Minor children of the deceased IRA owner.
- **Non-eligible designated beneficiaries** — anyone who doesn't meet one of the criteria above.

## RMDs FOR NON-DESIGNATED BENEFICIARIES — 5 OR LIFE

Non-designated beneficiaries such as charities or trusts continue to operate under the rules that were in place prior to 2019. If the IRA owner was more than age 73, these entities can stretch out the IRA and take distributions based on the deceased's age. If the owner died before age 73, the entity must distribute the entire IRA account within five years of the owner's death.

## RMDs FOR ELIGIBLE DESIGNATED BENEFICIARIES — STRETCH IT OUT

For eligible designated beneficiaries, the original stretch rules may still apply, with some complexities. In general these individuals open a new beneficiary IRA account and can then take annual RMDs based on their current age and the IRS tables for the remainder of their life.



Note that spouses are considered eligible designated beneficiaries, but most choose the simplicity of rolling the IRA into their own name.

An individual is deemed to be disabled by the IRS if the person cannot engage in substantial gainful activity due to physical or mental impairment. Meanwhile, in order to qualify under the chronically ill definition, a person must be unable to complete at least two of the six activities of daily living — eating, dressing, grooming, toileting, walking and transferring. The illness must be expected to continue for a lengthy, rather than temporary period.

A beneficiary under age 21 will qualify as a minor for stretch IRA purposes. Easy enough, right? Not so fast. Minors may stretch the IRA until they reach age 21. At that point, the 10-year rule then kicks in and they must distribute the entire account by their 31st birthday. During that 10-year window, will they have to take RMDs or can they just wait until the end to empty the account? It depends! In most cases it's likely a minor will be inheriting from a parent who died young, before age 73.

If the IRA owner died before starting RMDs, the minor doesn't need to take RMDs during the 10-year window. But if a minor inherits from someone older than 73 (i.e., a grandparent), they will have to take RMDs each year and empty the account by age 31.

Finally, in order to meet the "less than 10 years younger" test, you must look at actual dates of birth for the decedent and the beneficiary. For example, assume Lisa was born May 31, 1960, and named her cousins Jill (born Jan. 15, 1970) and Susan (born Oct. 20, 1970) as 50% beneficiaries. In this scenario, Jill will be able to stretch the IRA as she is 9 years and 9 months younger than Lisa. Susan on the other hand is 10 years and 5 months younger and would be subject to the rules below.

### **RMDs FOR NON-ELIGIBLE DESIGNATED BENEFICIARIES — THE 10-YEAR CLOCK IS TICKING**

If a beneficiary does not meet one of the criteria above, they fall into the newly created non-eligible designated beneficiary category. This is the group that stands to lose the most under the new regulations, since the ability to stretch an inherited IRA for life has been eliminated. This group most commonly includes children inheriting IRAs from their parents or grandparents, along with those inheriting from other family members or friends.

Non-eligible designated beneficiaries must distribute the entire inherited IRA by the 10th anniversary of the original IRA owner's death. Depending on the size of the IRA, this can mean a significant tax bill for the beneficiary, as these distributions are fully taxable at ordinary income rates.

What was unclear at the time the bill was passed was the timing of the distributions during the 10-year window. However, draft guidelines issued by the IRS clarified that if the deceased IRA owner was older than 73 and had been taking their own RMDs, then the beneficiary will be required to continue taking RMDs during the 10-year window (based on their own age) and empty the account by year 10.



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## **If you inherit an IRA from your spouse, you have an opportunity that other beneficiaries don't have.**

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If the IRA owner hadn't yet started RMDs before his/her death, the beneficiary simply must empty the account by the 10th anniversary of death.

The requirement that RMDs would be required for some during the 10-year period was a surprise to many in the tax and planning community. As a result, the IRS waived any penalties for those beneficiaries who did not take distributions in 2022 or 2023. So while technically those RMDs were required, many beneficiaries skipped them as there was no negative consequence in doing so. It's expected that these rules will be finalized and apply to everyone in 2024 and beyond.

### **INHERITING A ROTH IRA**

Although you don't have to take RMDs from your own Roth IRA during your lifetime, beneficiaries are subject to the same rules above. Spouses can roll the Roth IRA into their own name and skip distributions. Eligible designated beneficiaries must take RMDs each year, but they can stretch the Roth IRA over their lives.

Non-eligible designated beneficiaries must distribute the entire Roth IRA within 10 years of the original owner's death. If you're a surviving spouse, you can roll a Roth into your own name to avoid taking RMDs. The silver lining is that the amounts you withdraw from Roth accounts are tax-free.

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