TAX

IRS gives IRA heirs a break and more flexibility for financial advisors

By Tobias Salinger **August 03, 2023, 4:04 p.m. EDT4 Min Read**

For the third straight year after IRA inheritances that could previously "stretch" over a lifetime got changed to the span of a decade, the IRS delayed heirs' required minimum distributions.

The tweak, for most clients who received an individual retirement account after the death of its owner in the past three years, will push back the RMDs to "no earlier than 2024," the IRS said in a notice last month. The guidance was "almost a copy-paste of what they did last year" in giving IRA beneficiaries a break on the RMDs for 2021 and 2022 if they inherited their account after the Secure Act of 2019 eliminated the stretch at the beginning of 2020, said Grant Keebler, an associate at Green Bay, Wisconsin-based tax advisory and CPA firm Keebler & Associates.

Continued "grace periods" aren't likely to alter clients' obligation to empty the accounts into their income and pay the accompanying taxes in 10 years, Keebler said.

"By the time we get to 2024, it'll be 36 months since Congress told Treasury to go forth and write regulations, so I'd like to think that we're going to have good marching orders by then," he said. "I would struggle to see how they eliminate that requirement. I'm not sure that they have the statutory authority. Congress could step in to change it. We'll just have to wait and see."

The further one-year reprieve for 2023 means that clients who aren't spouses of the deceased account owner, minor children, chronically ill, disabled or of an age within 10 years of the late IRA giver can reap investment gains on the full amount in the portfolio without worrying about an excise tax penalty. Last year's Secure Act 2.0 made small but meaningful changes to those excise penalties, as well as some general RMD rules governing IRAs and other retirement plans that the IRS clarified in last month's notice, too.

Regardless, the additional year without RMDs for beneficiaries came as good news for many financial advisors, whose clients had gotten a break from the distributions in 2020 as well under a different law lifting them for all defined contribution plans amid the pandemic.

"The IRS just answered the #1 question on many advisors' minds," Jeff Levine, the chief planning officer of St. Louis-based Buckingham Strategic Wealth, tweeted after the IRS released the notice last month.

The extra year certainly provides "relief for IRA beneficiaries," said Rupa Pereira, the founder of Raleigh, North Carolina-based FWJ Planning.

"However, this means a higher balance may have to be withdrawn during the remaining period," she said in an email. She noted that those distributions could bump clients into different tax brackets and affect the calculation of their income for purposes of their childrens' financial aid applications or their monthly earnings calculation for Medicare.

"And sunsetting of the Tax Cuts and Jobs Act on Dec. 31, 2025 is looming right on the horizon," Pereira added, referring to the tax law passed during President Donald Trump's administration. "So lots to plan for to minimize the taxable bite."

Secure 2.0 reduced the excise penalty for unpaid RMDs to 25% or as low as 10% if corrected within two years from the previous 50% hit, according to the IRS. Another shift stemming from the legislation raised the age that a retirement plan holder must begin their RMDs to 73 in 2023 and 75 in 2033. As part of last month's regulatory notice, the IRS stated that IRA and 401(k) holders who turned 73 last year can make tax-free withdrawals, known as eligible rollover distributions, through Sept. 30 of this year.

"Payments to cover these initial RMDs could have been initiated as early as January 2023, and some taxpayers may have scheduled such payments accordingly," certified public accountant Ed Zollars wrote on the Kaplan Financial Education "Current Federal Tax Developments" blog. "However, the Secure 2.0 Act, passed late in 2022, altered the required beginning date for these taxpayers to April 1 of the year following the one in which they turn 73. Consequently, these 2023 payments became eligible rollover distributions. However, taxpayers may not have been aware of this change until after the 60-day rollover period had expired."

Many advisors and tax professionals got "surprised and frustrated" when Treasury rules issued in 2021 after the first Secure Act suggested that RMDs would have to begin that year, Keebler said. Since then, they may have realized that beneficiaries in their mid- to late 50s will only pay a little more than 3% of the account's year-end balance in an RMD, or a lower amount than the expected investment growth over 12 months, he noted.

"It's not some huge number to get really worked up about and spend a lot of energy planning for," he said, calling the "high-tax-bracket buzzsaw" of a massive distribution years down the line a bigger concern for advisors. "Forget whether the RMDs are required or not," he added. "If you're a prudent tax planner, there are plenty of situations where it would be rational to at least take some money out."

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