TAX

IRS offers 'Secure' relief to 10-year rule beneficiaries

By Jeffrey Levine October 24, 2023, 5:24 p.m. EDT21 Min Read

On Dec. 19, 2019, the Secure Act was signed into law by President Donald Trump. With the stroke of a pen, many of the long-standing rules governing IRAs and other retirement accounts were changed, pushing back the age at which individuals must begin taking required minimum distributions (RMDs) from their retirement accounts — from 70 1/2 to 72 (the starting age of 72 was later pushed back, itself, to 73 for some and 75 for others, by Secure Act 2.0) — and eliminating the maximum age at which Traditional IRA contributions can be made.

But while the Secure Act altered the retirement account rules in a number of meaningful ways, the clear consensus among both advisors and the public was that no single exception had a more seismic impact on planning than the Secure Act's changes to the post-death distribution rules for retirement accounts and the creation of the "10-year rule."

The changing designations of retirement account beneficiaries defined by the Secure Act and IRS regulations

Prior to the Secure Act, beneficiaries of retirement accounts were broadly categorized into two groups: non-designated beneficiaries and designated beneficiaries. The primary difference in the rules governing the two types of beneficiaries was the amount of time they were given to distribute assets from the inherited IRA, with designated beneficiaries getting the much better end of the deal.

Non-designated beneficiaries, such as charities and estates, were (and still are) required to empty inherited retirement accounts by the end of the fifth year after death when inheriting from an owner who died before their required beginning date. If death occurred on or after the decedent's required beginning date, distributions were required to be made over the decedent's remaining single life expectancy (or sooner), which was anywhere from on to roughly 15 years.

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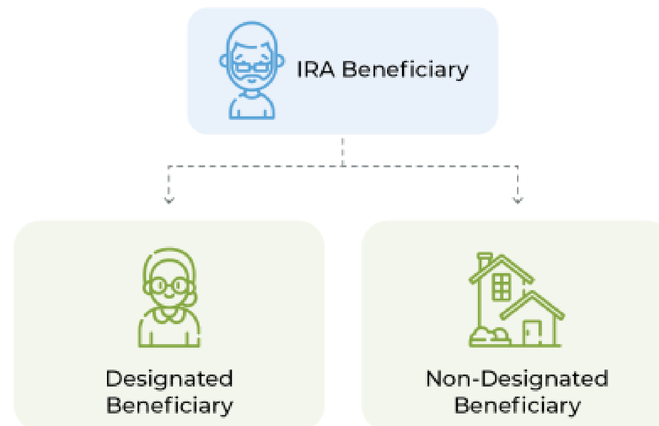
Pre-SECURE Act Beneficiary Classifications



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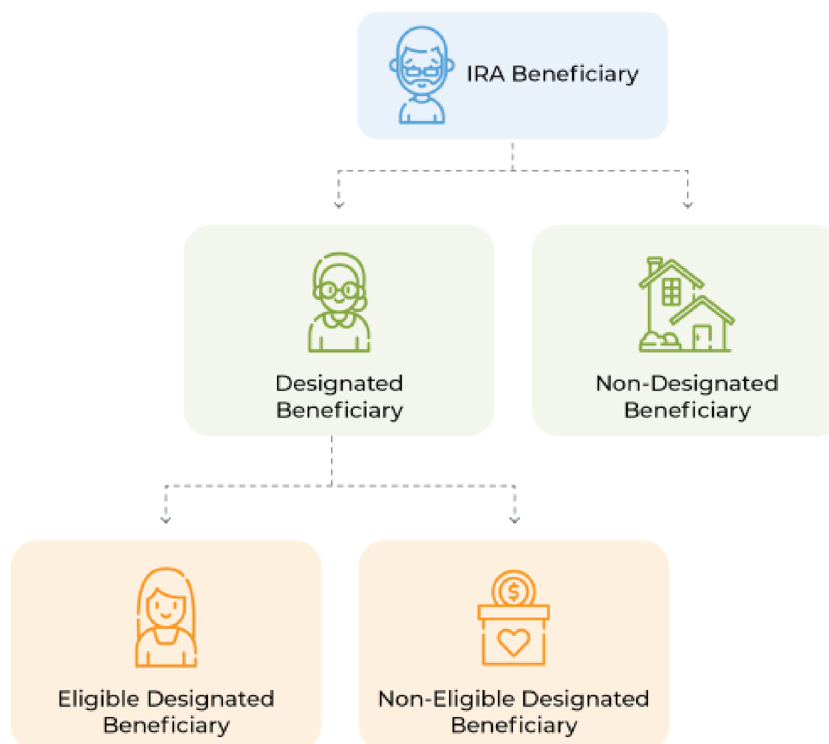
By contrast, designated beneficiaries — living, breathing people, as well as some trusts (those that qualified as See-Through Trusts) — were able to "stretch" distributions over their own life expectancy regardless of whether the decedent died before, on or after their required beginning date. For middle-aged beneficiaries (such as an adult child of the taxpayer, perhaps the most common non-spouse beneficiary), this meant the opportunity to spread out distributions over three to four decades, while younger beneficiaries (such as grandchildren) had the potential to spread distributions out over even longer periods of time.

And then, the Secure Act changed it all — or at least most of it.

How the Secure Act created subcategories of designated beneficiaries

With the enactment of the Secure Act, the previously homogenous group of designated beneficiaries was cleaved into two distinct subgroups: Eligible designated beneficiaries and non-eligible designated beneficiaries. Eligible designated beneficiaries — a group that includes surviving spouses, persons who are disabled, persons who are chronically ill, persons who are not more than 10 years younger than the decedent and minor children — were allowed to continue stretching distributions from inherited retirement accounts.

For non-eligible designated beneficiaries, on the other hand, their ability to stretch distributions over their life expectancy was eliminated and replaced with a new non-eligible.



More specifically, section 401 of the Secure Act created new IRC Section 401(a)(9)(H)(i) applicable to designated beneficiaries, which reads:

In general. — Except in the case of a beneficiary who is not a designated beneficiary, ***subparagraph (B)(ii)*** *—*

I. shall ***be applied by substituting "10 years" for "five years,"*** *and*

II. shall apply whether or not distributions of the employee's interests have begun in accordance with subparagraph (A). [emphasis added]

The "five years" in the excerpt above references the five-year rule (as described under the referenced "subparagraph (B)(ii)") applicable to non-designated beneficiaries (e.g., charities, estates) when the deceased retirement account owner died prior to their required beginning date. And that five-year rule had/has always "just" required that the non-designated beneficiary empty the account by the end of the fifth year after the decedent's death, with no annual distributions required during the interim.

Thus, after the Secure Act, most practitioners assumed that the 10-year rule would work in the same manner; that is to say that non-eligible designated beneficiaries would simply be required to empty their

inherited retirement accounts by the end of the 10th year after the decedent's death, but that no distributions would be required during the first nine years.

In the initial years after the Secure Act's passing, all signs pointed to this initial interpretation of the 10-year rule being the correct interpretation of the rule. In fact, even the IRS seemed to agree with the position, stating the following in a revised version of Publication 590-B, Distributions from Individual Retirement Arrangements (IRAs), published on May 25, 2021:

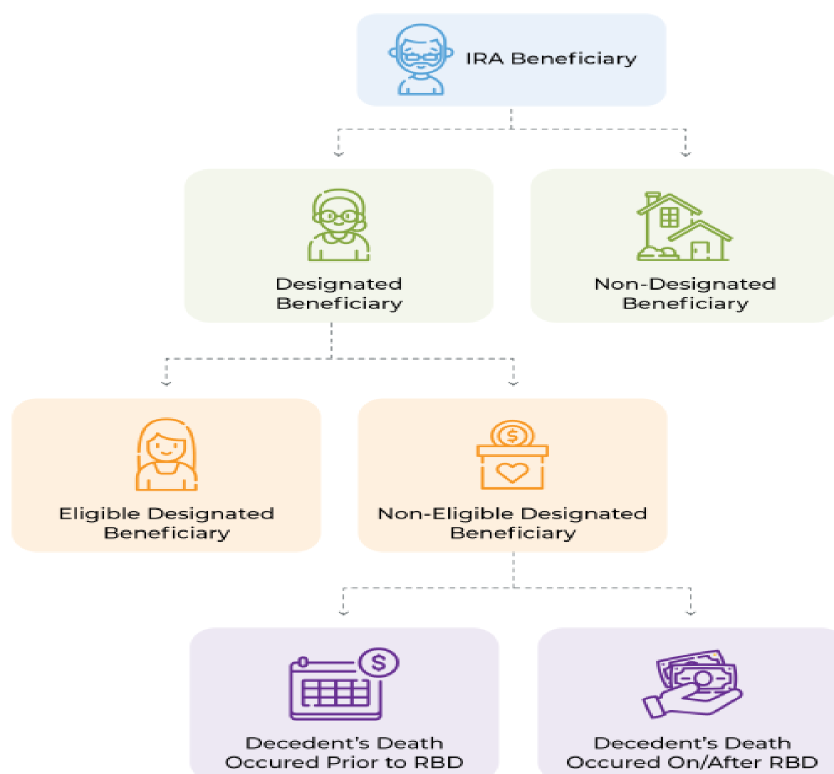
10-year rule. *The 10-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw the entire balance of the IRA by December 31 of the year containing the 10th anniversary of the owner's death. For example, if the owner died in 2020, the beneficiary would have to fully distribute the plan by December 31, 2030.* ***The beneficiary is allowed, but not required, to take distributions prior to that date.*** [emphasis added]

IRS proposed regulations bifurcate non-eligible designated beneficiaries

But on Feb. 23, 2022, the IRS threw the planning world a curveball when it issued proposed regulations to reflect the changes made by the Secure Act. In what came as a shock to nearly all practitioners, the proposed regulations called for yet another bifurcation of beneficiaries. More specifically, the proposed regulations require that the group of non-eligible designated beneficiaries be further divided into non-eligible designated beneficiaries who inherit from decedents dying before their required beginning date and non-eligible designated beneficiaries who inherit from decedents dying on or after their required beginning date.

For non-eligible designated beneficiaries inheriting from individuals dying prior to their required beginning date, the proposed regulations call for the non-eligible to be implemented in a manner consistent with initial expectations. Accordingly, all such beneficiaries need to do is empty their inherited retirement account by the end of the 10th year after death. No RMDs are required in the interim.

By contrast, the same proposed regulations call for non-eligible designated beneficiaries inheriting from someone dying on or after their required beginning date to be subject to both the 10-year rule *and* the "regular" stretch distributions. In other words, the proposed regulations require such beneficiaries to take at least the same minimum distributions they would have from the inherited account in years one through nine after the death of the owner as they would have before the Secure Act and, on top of that, empty whatever happens to be left in the account by the end of the 10th year after death!



IRS notices address concerns over missed RMD penalties

Needless to say, at first, the interpretation of the Secure Act's 10-year rule put planners in a bit of a difficult situation. On the one hand, proposed regulations are just that — proposed! There's no guarantee that the final regulations will include the same interpretation of the 10-year rule (requiring distributions in years one through nine). On the other hand, if the final regulations do arrive in a substantially similar format, those who failed to take the distributions contemplated by the proposed regulations could have left themselves susceptible to a 50% penalty (which has since been reduced to 25%, or 10% if rectified during the correction window, by Secure 2.0 last December) on the missed RMD!

In response to this dilemma — the lack of a definitive stance provided in final regulations and the overall concern regarding potential penalties — in October 2022, the IRS released Notice 2022-53, Certain required minimum distributions for 2021 and 2022. In the notice, IRS waived any potential penalties for non-eligible designated beneficiaries for 2021 and 2022 (only) for missing RMDs from their inherited retirement accounts. The notice further stated that the earliest that the final regulations would apply would be 2023, but offered no clue what the final regulations would say.

Thus, while the notice provided some much-needed clarity to advisors and their clients through the end of 2022, it left the same individuals wondering, once again, what to do, as the calendar turned to 2023.

Thankfully, the IRS didn't push things to the last minute in 2023. Rather, on July 14, the IRS released Notice 2023-54, Transition Relief and Guidance Relating to Certain Required Minimum Distributions. And as a result of that notice, we no longer have to wonder whether certain beneficiaries will have to take RMDs from their inherited IRAs during the 10-year rule for 2023.

Specifically, the notice, once again, provides relief for non-eligible designated beneficiaries who inherited from someone dying on or after their required beginning date by eliminating any penalties for failing to take (potential) RMDs for 2023.

Unfortunately, however, that's about all the notice does with regard to clarifying the rule for post-death distributions from inherited retirement accounts. For instance, the notice lacks any detail as to when we might be able to expect final regulations.

From the notice: "APPLICABILITY DATE OF FINAL REGULATIONS: Final regulations regarding RMDs under § 401(a)(9) and related provisions will apply for calendar years beginning **no earlier** than 2024." [emphasis added]

Recall that in last year's Notice 2022-53, the IRS told us that final regulations would not apply until as early as this year (2023). Now, we know final regulations won't apply until as early as next year. How long will history continue to repeat itself?

It's hard to say at the moment. IRAs were created in 1974 by the Employee Retirement Income Security Act (ERISA), but it wasn't until 28 years later, in 2002, that the IRS finally got around to issuing final regulations detailing the post-death distribution rules. It seems unlikely that the IRS will take anywhere near as long this time to produce the necessary regulations, but it is still trying to dig itself out of a massive backlog that was amplified by the pandemic and Congress has since complicated the issue by changing many of the rules for retirement accounts again via Secure Act 2.0.

And it bears repeating that just because the proposed regulations call for certain beneficiaries subject to the 10-year rule to take RMDs during the initial nine years after death, the IRS could have a change of heart when(ever) it finally does release final regulations.

Consider the following excerpt from Notice 2023-54: "Definition of specified RMD. For purposes of this notice, a specified RMD is any distribution that, **under the interpretation included in the proposed regulations,** would be required to be made…." [emphasis added]

Note that the IRS does not say "as required by Secure Act…" or something to a similar effect. Rather, it plainly acknowledges that the rule in question was its own interpretation of the rule.

Perhaps the plethora of hate mail comment letters that the IRS received in response to its surprising interpretation will sway it to adopt a simpler, more taxpayer-friendly interpretation of the 10-year rule.

Voluntary distributions should still be considered before year-end

Although Notice 2023-54 makes it clear that all non-eligible designated beneficiaries (both those who inherited from someone dying before their required beginning date as well as those who inherited from someone dying on or after their required beginning date) are spared from the requirement to take distributions from their inherited accounts this year, that doesn't mean that such individuals shouldn't voluntarily take distributions anyway. In fact, as the great Admiral Ackbar so succinctly put it: "It's a trap!"

That's right. It's a trap. Or at least it has the potential to be one for many affected beneficiaries. Consider the fact that the disappointment and frustration felt by many after the Secure Act's elimination of the stretch (for most non-spouse beneficiaries) was because the 10-year rule significantly compresses the number of years over which such beneficiaries have to spread out the income from their inherited accounts.

Somewhat ironically, many of the same people lamenting the compression of the distribution schedule are the same ones hoping not to have to take distributions from their inherited IRAs during the 10-year rule. But each year of the 10-year rule in which an individual does not take a distribution — regardless of whether such distribution is required or whether a beneficiary simply chooses to take one voluntarily — means more income will be left to take during the remaining years.

For beneficiaries who anticipate a dramatic reduction in income towards the tail end of their own personal 10-year rule schedule (e.g., they plan to retire six years into the 10-year rule), eschewing distributions during the early years of the 10-year period might make sense. But for the *many* beneficiaries whose income is likely to remain fairly constant throughout the 10-year rule or is expected to rise during that time, delaying distributions in the early years effectively creates a self-imposed four-year rule, three-year rule, etc.

In the most extreme situation, where no distributions are taken during the first nine years after death, beneficiaries subject to the 10-year rule must fully deplete their inherited IRA accounts in one year, the 10th year after death.

Simple application of the Rule of 72 provides that an inherited retirement account earning 7% per year would roughly double by the end of the 10-year period. Even a modest inheritance then, after doubling, can easily push a beneficiary into a much higher tax bracket, phase the beneficiary out of valuable deductions and credits, increase the beneficiary's Medicare Income-Related Monthly Adjustment Amount (IRMAA) two years after the distribution, or trigger any number of other undesirable consequences linked to higher income.

To avoid such challenges, the more appropriate strategy for many beneficiaries is to take distributions from the inherited IRA throughout the 10-year period, thereby reducing the possibility of larger income spikes down the road.

What should affected beneficiaries who don't want to take distributions do in 2024?

This year, the IRS provided us with guidance through Notice 2023-54 on the current application of the 10-year rule much earlier than it did in 2022. Unfortunately, there's no guarantee that it will do the same thing next year. Accordingly, advisors and clients should have a game plan for how they want to approach 2024.

For clients subject to the 10-year rule who either need to take distributions from their inherited retirement accounts or who will do so to minimize the long-term tax impact, the plan is pretty straightforward: Just take the necessary distribution prior to the end of 2024. However, for clients who would prefer to avoid adding income to their return in 2024 but who, under the proposed regulations, should be taking a distribution, the decision could be more nuanced.

Of course, the most obvious course of action for such individuals is to simply wait. In all likelihood, similar to this year (and last year), even if the IRS does not release final regulations, it will provide

taxpayers with some sort of 10-year rule guidance for 2024 before it gets too late in the year. If it doesn't, some beneficiaries may have a more difficult decision to make.

Taking at least the minimum that would be required under the proposed regulations would effectively eliminate any possibility of the IRS imposing a penalty for a missed RMD. On the other hand, choosing not to take such a distribution could work out just fine if the IRS revises its 10-year rule interpretation in its final regulations (whenever they're issued).

But what if the IRS doesn't change its mind and such beneficiaries fail(ed) to take required distributions for 2024 (or subsequent years)? What's the worst-case scenario? Indeed, this has been a common question amongst advisors in each of the past two years prior to the release of the relevant IRS notices.

Interestingly, as noted earlier, the potential penalty for missing such a distribution was significantly reduced last December with the passage of the second installment of the Secure Act, Secure 2.0. Instead of the 50% penalty that used to apply to such distributions, the new penalty for an RMD shortfall was reduced immediately to 25%. Furthermore, in the event that a taxpayer takes corrective action to make up a missed RMD during what Secure 2.0 refers to as the "correction window" (which can vary in length based on a variety of factors but should generally comprise at least a multiyear period), the 25% penalty is further reduced to "just" 10%.

But there's a good chance that such individuals wouldn't even need to pay the 10% penalty. Notably, despite the reduction in the maximum penalty for a missed RMD, taxpayers are still able to submit a request to the IRS to abate the penalty. Historically, the IRS has been fairly lenient in providing taxpayers with relief from the penalty if they could provide *any* sort of reasonable explanation. And "I wasn't really sure what to do because there weren't any Final Regulations before now" would seem, on the surface at least, to be a pretty darned reasonable excuse!

To avoid potential blowback from a client's tax preparer (who would likely be on the hook to request such relief, if necessary), advisors would likely be best served to make sure all relevant parties — the advisor, the client, and the client's tax preparer — are on the same page. And given that it won't be an issue until next year, there's not much of a rush to do so; the conversation can simply be cued up for the next group meeting or even when the client visits with their tax preparer in 2024 to file their 2023 taxes.

Additional RMD relief for individuals born in 1951

In addition to the relief from potential RMD penalties provided to certain non-eligible designated beneficiaries as described above, Notice 2023-54 also offers a temporary RMD reprieve to individuals born in 1951 who, until the passage of Secure Act 2.0 on December 29, 2022, were set to begin taking RMDs this year.

More specifically, just a handful of years after the original Secure Act changed the age at which RMDs begin from 70 1/2 to 72, Section 107 of Secure Act 2.0 further pushed back that starting age to 73 for individuals born between 1951 and 1959, and to age 75 for those born in 1960 and later years.

Impact Of SECURE Act & SECURE 2.0 Act On RMD Age

Birthdate Year	Age Beginning January 1 in Current Year													
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
1944	76	77	78	79	80	81	82	83	84	85	86	87	88	89
1945	75	76	77	78	79	80	81	82	83	84	85	86	87	88
1946	74	75	76	77	78	79	80	81	82	83	84	85	86	87
1947	73	74	75	76	77	78	79	80	81	82	83	84	85	86
1948	72	73	74	75	76	77	78	79	80	81	82	83	84	85
1949	71	72	73	74	75	76	77	78	79	80	81	82	83	84
1950	70	71	72	73	74	75	76	77	78	79	80	81	82	83
1951	69	70	71	72	73	74	75	76	77	78	79	80	81	82
1952	68	69	70	71	72	73	74	75	76	77	78	79	80	81
1953	67	68	69	70	71	72	73	74	75	76	77	78	79	80
1954	66	67	68	69	70	71	72	73	74	75	76	77	78	79
1955	65	66	67	68	69	70	71	72	73	74	75	76	77	78
1956	64	65	66	67	68	69	70	71	72	73	74	75	76	77
1957	63	64	65	66	67	68	69	70	71	72	73	74	75	76
1958	62	63	64	65	66	67	68	69	70	71	72	73	74	75
1959	61	62	63	64	65	66	67	68	69	70	71	72	73	74
1960	60	61	62	63	64	65	66	67	68	69	70	71	72	73

SECURE Act RMD Age = 72 beginning on Jan 1, 2020
SECURE 2.0 RMD Age = 73 beginning on Jan 1, 2023
SECURE 2.0 RMD Age = 75 beginning on Jan 1, 2033

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The change made by SECURE 2.0 had no impact on individuals born in 1950 or earlier, as they had turned 72 by 2022 and had already started taking RMDs. Those born in 1952 or later were affected but had ample time to prepare for the change (since they wouldn't have been required to start taking RMDs until 2024, absent the changes made by SECURE 2.0).

Rollover concessions for 2023 distributions originally intended as RMDs for those born in 1951
But for individuals born in 1951, the change in RMD age beginning in 2023 may have been welcome, but it came with little time to spare. With the passage of Secure 2.0 just literal days before the New Year, many of those born in 1951 had already set up automatic distributions from their retirement accounts for what they thought were going to be RMDs this year. Similarly, many employer plans had already "programmed in" distributions for such individuals to begin as early as January.

Accordingly, many distributions of what would have been RMDs if not for Secure 2.0 were received by taxpayers in 2023 before either they and/or their plan could turn them off. Similarly, many taxpayers received distributions of such amounts before they even learned of the change in RMD age ushered in by Secure 2.0.

In recognition of the timing of the passage of Secure 2.0 and to accommodate such taxpayers whose RMD required beginning dates were impacted in 2023 (i.e., taxpayers who were born in 1951), Notice 2023-54 includes additional relief for such individuals who may have received distributions in 2023 by July 31 (that, prior to Secure 2.0, would have been an RMD), permitting them to rollover the distributions outside of the 60-day window, provided such rollovers are completed before the end of September 2023.

Example 1: In October 2022, Mindy, who was born in 1951, signed paperwork to have what she thought was going to be her 2023 RMD distributed to her in January 2023. However, as a result of Secure Act 2.0 enacted on December 29, 2022, the planned distribution was no longer an RMD.

Neither Mindy nor her custodian stopped the distribution from being processed, so in January 2023, Mindy received the would-have-been-an-RMD. Furthermore, she didn't learn that her January 2023 distribution was not an actual RMD until she met with her tax preparer in April 2023, well past the end of the 60-day rollover window.

As a result of the relief provided by Notice 2023-54 (and because she received the funds by the July 31 deadline), Mindy may rollover the January 2023 distribution until Sep. 30, 2023.

Impact of non-RMD rollovers on once-per-year rollover rules
In addition to granting those born in 1951 the ability to complete a late rollover of 2023 distributions received prior to Aug. 1, 2023, Notice 2023-54 also allows such rollovers to be completed, even if they would otherwise be in violation of the once-per-year rollover rule.

For instance, suppose that Mindy, from the above example, received a distribution from her IRA in September 2022 that was later rolled over to another retirement account before the end of the 60-day rollover window.

In general, as a result of the September 2022 60-day rollover, Mindy would be prohibited from making any subsequent IRA-to-IRA or Roth IRA-to-Roth IRA 60-day rollovers for the following year (365 days). However, as a result of the relief provided by Notice 2023-54, prior rollovers may be disregarded with respect to the once-per-year rollover rule, allowing Mindy to complete the 60-day rollover of the amount that, save for Secure ACT 2.0, would have been an RMD.

Interestingly, while Notice 2023-54 allows those born in 1951 to disregard prior rollovers when determining whether a distribution mischaracterized as a 2023 RMD (that was received before August 2023) can be rolled over before the end of September 2023, it does require that such rollovers be considered when determining whether future IRA distributions can be rolled over.

According to the Notice: "However, making such a rollover of the portion of an IRA distribution mischaracterized as an RMD will preclude the IRA owner or surviving spouse from rolling over a distribution in the next 12 months."

Notably, the once-per-year rollover rule clock begins ticking on the date that the taxpayer receives the first distribution — not on the date that it is rolled over. Thus, for affected taxpayers rolling over distributions received early in 2023, the once-per-year rollover rule may only preclude rollovers for another few months, even if they wait until as late as September to rollover the distribution!

Example 2: Recall Mindy, from Example 1 above, who received a distribution in January of 2023 that would have been an RMD had Secure 2.0 not been enacted. Suppose, now, that the distribution in question was received on Jan. 15, 2023.

Further, suppose that Mindy takes advantage of the relief provided by Notice 2023-54 and rolls that distribution over on Sept. 20, 2023. In such an instance, Mindy will be able to rollover any distributions she received after 365 days from the Jan. 15, 2023, receipt of the distribution (and *not* 365 days from the Sept. 20, 2023, date the rollover was completed)!

Of course, it should go without saying that instead of making 60-day rollovers, a far better way to move retirement account money is to do directly between institutions, either as a direct rollover — e.g., 401(k)-to-IRA or as a direct transfer (between IRAs or Roth IRAs). Moving money in such a manner not only eliminates any once-per-year rollover issues but also avoids any 60-day rollover window concerns.

A final word of caution on the relief provided in Notice 2023-54 for those born in 1951: The relief *only applies to amounts that would have been RMDs* if not for Secure 2.0. So, if such an individual took a large distribution earlier this year that they now wish to be able to return (before the end of September), any amounts in excess of their 2023 "RMD" are ineligible to be rolled over (if outside of the 60-day window).

In recent years, Congress has been busy redefining the rules for retirement accounts. Unfortunately, though, even in the best of circumstances, where bills are carefully drafted and reviewed intensely prior to receiving a Congressional vote, mistakes can happen, and gaps remain that need to be filled in via the IRS and regulations. And neither the Secure Act nor its successor Secure 2.0 were enacted in "the best of circumstances." Thus, much remains for the IRS to clarify to both taxpayers and their advisors.

For now, though, at least we have Notice 2023-54 to help guide the way. Not only does the Notice answer the single most asked question by advisors in 2023 — "Does my client subject to the 10-year rule need to take a distribution from their inherited retirement account this year?" — but it also provides those born in 1951 with the sort or reasonable relief one would have for when Congress decides to change the rules for a lifetime's worth of savings 3 days before kick-off.

Ultimately, we're still in the early innings of figuring out how to handle the changes made by the Secure Act and Secure 2.0, meaning there will be plenty of opportunities for advisors to keep clients up to date on the latest changes and to demonstrate their value.

Make no mistake… brace yourself!

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