

Surprise! The IRS Changes Its Mind

March 2022

THE IRS' PROPOSAL

On December 20, 2019, the ***Setting Every Community Up for Retirement Enhancement*** (SECURE) Act was signed into law and brought with it significant changes in planning for retirement account owners – particularly around the timing of IRA distributions for beneficiaries.

Not surprisingly, the SECURE Act included several provisions that were somewhat ambiguous and left open to substantial IRS interpretation. It is common practice for the IRS to publish how it has interpreted and plans to regulate new tax laws, and for more than two years, practitioners have been anxiously awaiting the issuance of Treasury Regulations that would provide guidance to income tax practitioners and their clients.

If you are like me – this is the time of year that you gaze at the calendar and try to imagine what life will be like after April 15 – when your income tax return filing has been completed, and that ominous deadline no longer looms large on your horizon. Almost as if the IRS sensed the public's craving for more information around taxation, in February it issued the [Proposed Regulations](#) to reflect the changes to the Internal Revenue Code made by the SECURE Act. While they are hefty at 275 pages long – keep in mind, these Proposed Regulations are not yet finalized and are likely to be amended at least somewhat before that happens. However, the Proposed Regulations shed light on the IRS' current thinking on a variety of issues to date.

ISSUES ADDRESSED IN THE PROPOSED REGULATIONS

There are several points of clarification that the IRS addresses in the Proposed Regulations. We will list them here and then go into more depth on the first one regarding the 10-year rule for beneficiaries.

- If the IRA owner died on or after he/she reached the “required beginning date” for distributions, then “*Non-Eligible Designated Beneficiaries*” will need to take distributions each year up until the final distribution in the 10th year. We provide more detailed discussion of this guidance under “The Surprise” below.
- The Proposed Regulations clarify who can be considered an “Eligible Designated Beneficiary” (and who is able to use the previous ‘stretch’ required minimum distribution (RMD) rules rather than the 10-Year Rule). For purposes of our discussion this month it's important to point out that “*Eligible Designated Beneficiaries*” fall into one of the following five groups:
 - Surviving spouses
 - Individuals who are disabled
 - Persons who are chronically ill
 - Persons not more than 10 years younger than the deceased individual
 - Minor children (under age 21) of the decedent



- Proposed Regulations Would Clarify Application of Change of RMD Starting Age To Surviving Spouse Beneficiaries.
- Eligible Designated Beneficiaries Can opt Out Of ‘Stretch’ And Into 10-Year Rule, But Custodians Can Limit Options.
- Proposed Regulations provide new guidance on trust beneficiaries of retirement accounts.

THE SURPRISE

With the introduction of the 10-Year distribution rule – the planning around IRA distributions after the owner’s death in many ways was greatly simplified. Under the new law, in most cases, non-spouse beneficiaries were now simply required to distribute the entirety of their inherited retirement account by the end of the tenth year after the decedent’s death.

Most practitioners read the law and took it at its face value, assuming the beneficiaries would have the flexibility to take out as much, or as little, as desired in each of the first nine years after the owner’s death (as long as anything still left in the 10th year after death was distributed by the end of that year).

However, in early 2021, the IRS issued its annual update to Publication 590-B, Distributions from Individual Retirement Arrangements (IRAs), which included an example that seemed to indicate that Non-Eligible Designated Beneficiaries would be **required** to abide by regular stretch RMDs **in addition to the 10-Year Rule**.

As you might imagine, [practitioners expressed their confusion](#) about the Publication to the IRS, and a few weeks later, an IRS spokesperson indicated that the initial version contained a mistake, and that a corrected version of the Publication would be issued.

Sure enough, on May 25, 2021, the IRS posted a revised version of Publication 590-B, and a cursory look at the revisions would suggest the IRS was signaling that the original interpretation of the 10-Year Rule was correct - that is, *Non-Eligible Designated Beneficiaries* would **not** be required to take any distributions until the 10th year after the retirement account owner’s death.

Here is from page 12 of the [revised Publication 590-B](#):

 <p>Department of the Treasury Internal Revenue Service</p> <p>Publication 590-B Cat. No. 66303U</p>	<p>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.</p>
--	---



Enter the Proposed Regulations. On February 23rd of this year, the IRS changed direction again and stated that RMDs are *indeed* required during the first 9 years after an IRA owner's death, in certain circumstances. It is not clear what economic benefit the IRS sees in overcomplicating this rule, but regardless, the new Proposed Regulations divide Non-Eligible Designated Beneficiaries into two distinct groups, each with its own set of post-death distribution rules.

- **IRA Owner died before age 72:** One group would be comprised of Non-Eligible Designated Beneficiaries who inherited from retirement account owners who died prior to their Required Beginning Date. This group of beneficiaries needs only to follow the 10-Year Rule – that is, no mandatory distributions until the 10th year after the owner's death.
- **IRA Owner died after on or after age 72:** Non-Eligible Designated Beneficiaries who inherited from retirement account owners who died on or after their Required Beginning Date would comprise the second group. And this group of beneficiaries would be subject to both the 10-Year Rule and 'regular' 'stretch' distributions during years 1 through 9.

Well, surprise, surprise. If Tom Brady can change his mind, why can't the IRS?

CONCLUSION

The Proposed Regulations provide insight into how the IRS is thinking about updating its rules to accommodate the changes made by the SECURE Act. Based on the large outcry I have seen coming from those in tax practitioner circles, regarding what is seen as needless complication, it is likely that the IRS will receive a substantial number of comment letters recommending a simpler implementation of the rules around RMDs for Non-eligible designated beneficiaries.

Also, it remains to be seen how the IRS will handle IRA beneficiaries who did not take anything from their inherited IRAs in 2021 (remember the IRS suspended RMDs in 2020, due to COVID), but who would have been required to if the Proposed Regulations become final. There could be a safe harbor or transition rule – but we will need to wait for more guidance along those lines.

They are just proposals at this time, but history tells us that much of the Proposed Regulations are likely to remain the same when the comment period is over, and they are finalized. Furthermore, it is likely that we'll have a final version of the regulations before the end of the year.

Planning involves necessary complications sometimes – and the IRS is often quick to oblige. Please be sure to seek the advice of your financial planning and tax professionals when considering taking distributions from your inherited IRA.

Sincerely,



James Landry, ChFC
Chief Operating Officer, Director of Planning
Pallas Capital Advisors

Pallas Capital Advisors, LLC and its representatives do not provide legal or tax advice. You should consult a legal or tax advisor regarding any legal or tax information as it relates to your personal circumstances. These materials are provided for general information and educational purposes based upon publicly available information from sources believed to be reliable – we cannot assure the accuracy or completeness of these materials. The information in these materials may change at any time and without notice. The information in these materials may change at any time and without notice. The information contained herein is for informational purposes only, is not personalized investment advice, and should not be construed as a recommendation to purchase or sell any particular security, sector, or strategy to any individual person or entity. Investment Advice offered through Pallas Capital Advisors, LLC, a registered investment advisor.