

Decoding the 10-Year Rule for Inherited IRAs

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DID YOU INHERIT AN IRA AFTER 2019?

If you've been puzzled over when to start taking distributions, you're not alone. The wait is over, and we've finally got some clarity.

In December 2019, the SECURE Act was signed into law introducing a new 10-year distribution rule on most non-spouse inherited retirement accounts. There has been much confusion regarding whether the new IRA owner is required to take minimum distributions in years prior to the 10th year after the death of the original owner. Many inherited IRA owners have not been taking distributions – with the hope that those distributions would not be required until the 10th year.

For some more context, we wrote about this issue back in March of 2022 [here](#), and again in November, 2023 [here](#).

GRACE FROM THE IRS

Due to much confusion around application of the new rules, the IRS issued guidance earlier this year stating there is no penalty for not taking an annual distribution in 2024. This follows similar relief issued by the IRS in 2021, 2022 and 2023. The IRS has also stated it will not require missed distributions to be made up.

However, grace from the IRS is not unlimited.

[On July 18, the IRS issued final regulations](#) that clarify that beginning in 2025, someone (other than a spouse) who inherits an IRA (but not a Roth IRA) must take required minimum distributions from the IRA beginning the year after the death of the IRA owner. Plus, the entire IRA balance must be completely distributed by December 31 of the 10th year following death of the IRA owner. This 10-year rule also applies to inherited Roth IRAs.

BREAKING DOWN THE RULES: WHAT YOU NEED TO KNOW

So now it is clear that there are two versions of the 10-year rule depending on the age of the account owner at death:

1. Death before required beginning date (RBD). This is the simple 10-year rule. The IRA (and Roth IRA) must be fully distributed (at least) by the end of the 10th year following year of death of the owner. Before then, no annual distributions are required.
2. Death after RBD. The account still must be fully distributed by the end of the 10th year, but there must also be (except in the case of Roth IRAs) annual distributions which are calculated based on the account beneficiary's life expectancy.

The RBD is generally April 1 of the year following the calendar year in which the account owner reaches age 73. In the case where an account owner passes away after the RBD, designated beneficiaries and eligible designated beneficiaries may also opt to base annual distributions on the remaining life expectancy of the deceased account owner.

PRACTICAL PLANNING CONSIDERATIONS

1. These new rules only apply to non-spouse beneficiaries. If you are the widow/er of a deceased IRA owner, then there still are several options:
 - The spouse can continue to receive distributions from the inherited IRA account,
 - The spouse can roll the IRA over to a new account in his/her name (and delay RMDs until age 73),
 - The spouse can step into the shoes of the deceased IRA owner and begin taking distributions when the deceased would have started.
2. Watch out for ballooning distributions – and the big tax bills that follow. If the new IRA owner decides to only take the RMD for the first 9 years – there will be a (relatively) large balloon distribution due in the 10th year. Depending on the individual's personal income tax situation, that may not be the most efficient way to distribute funds from the IRA.
3. Avoid penalties. Since the 10-year rule may result in the distribution of retirement account balances sooner than anticipated, there may be unintended income tax issues for beneficiaries. Remember, if you miss a required distribution, the penalty tax is 25% of the total distribution amount, in addition to income tax on the amount distributed. (In a separate 2022 retirement law, Congress cut the penalty from 50% effective 2023.)
4. Account owners may consider spending down (or converting to a Roth) retirement funds while living, depending on their tax circumstances. (Unfortunately, inherited IRAs may not be converted to Roth IRAs.)
5. Account owners may want to leave other assets to higher-income heirs, leaving tax-deferred retirement funds to beneficiaries in lower, or moderate, income tax brackets.
6. Individuals aged 70½ and older can consider using qualified charitable distributions (QCDs) as a tax-efficient strategy to withdraw funds from their IRA or Inherited IRA, while also supporting charitable causes.
7. Speaking of charity – if an IRA owner has significant charitable estate planning objectives – leaving IRAs directly to charity (for example at the death of the surviving spouse), and instead leaving non-retirement and/or Roth IRA funds to children can be a very tax-efficient way to transfer wealth.
8. Inherited Roth IRAs do not have to take RMDs for the first 10 years. However, they must be fully distributed by the end of the 10th year following the death of the original Roth IRA owner. If possible, heirs of Roth IRAs may wish to wait until the last year of the 10-year period before distributing the account, allowing for potential tax-free growth over that period. Roth IRA distributions are tax-free to the beneficiary as well.
9. Heirs who inherited IRAs before 2020 are still subject to the old rules, which require annual withdrawals over their expected lifetimes.

WHAT SHOULD YOU DO?

There's no one-size-fits-all answer, which is why seeking professional advice is crucial. A detailed review of your personal circumstances will help identify the best options for you, whether you're a surviving spouse or another beneficiary. As an IRA owner, understanding the choices available to your beneficiaries can also guide your holistic planning approach.

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