Summer 2022

Estate Planning Update Summer 2022 - New Proposed Regulations Impact Inherited Retirement Plans

In February, the U.S. Treasury published proposed regulations of which beneficiaries of inherited retirement plans need to be aware. The SECURE Act, which became effective in 2020, eliminated the ability of many beneficiaries of inherited retirement plans to stretch out withdrawals over their lifetime. Retirement plans include individual retirement accounts and other tax-deferred retirement accounts, including 401(k) and 403(b) plans. The proposed regulations, surprisingly, require that beneficiaries of many inherited retirement accounts continue to take annual distributions from the accounts.

Specifically, under the SECURE Act, an ordinary designated beneficiary (i.e., not an "eligible designated beneficiary") is required to receive the entire account within 10 years of the original account owner's death. Since its enactment, many practitioners, even those who are experts on retirement plans, believed that the concept of Required Minimum Distributions (RMDs) was eliminated in all instances where the 10-year rule applied. The proposed regulations clarify the 10-year rule vis-a-vis the RMD rules.

Eligible designated beneficiaries retain the ability to stretch distributions over their lifetime. An eligible designated beneficiary is any designated beneficiary who, on the date of the original account owner's death, is (i) the account owner's surviving spouse, (ii) a minor child of the account owner, (iii) disabled, (iv) chronically ill or (v) not more than 10 years younger than the account owner.

Generally speaking, where a properly drafted trust is a designated beneficiary, one can look through the trust to the beneficiaries to determine the applicable rules for distributions.

Account Owner Dies Before Required Beginning Date

The proposed regulations provide that if the original account owner dies *before* the required beginning date (now age 72) and the proceeds from the account are left to an ordinary designated beneficiary, no distributions are required until the year of the 10th anniversary of the original account owner's death, at which time the entire account must be distributed. If the beneficiary is an eligible designated beneficiary, distributions are made in annual installments over the life expectancy of the eligible designated beneficiary, and the entire account must be fully distributed 10 years after the eligible designated beneficiary's death if it was not exhausted sooner by the beneficiary's life expectancy distributions.

Account Owner Dies After Required Beginning Date

If the original account owner dies *on or after* the required beginning date, annual distributions to the eligible designated beneficiary will be made over the longer of (i) the original account owner's life expectancy (as if he or she were still living) and (ii) the eligible designated beneficiary's life expectancy; however, the entire account must be distributed upon the earliest of (i) the year that contains the 10th anniversary of the eligible designated beneficiary's death, (ii) the final year of the eligible designated beneficiary's life expectancy and (iii) the final year of the deceased account owner's life expectancy. A notable exception: If the eligible designated beneficiary is a minor child, the entire account must be distributed by the child's 31st birthday or 10 years after the child's death, whichever is earlier.

If the account owner names an ordinary designated beneficiary, the entire account must be distributed upon the earlier of (i) the year of the 10th anniversary of the original account owner's death and (ii) the final year of the ordinary designated

beneficiary's life expectancy; however, during this period, distributions must be made annually over the longer of (A) the ordinary designated beneficiary's life expectancy and (B) the account owner's life expectancy (as if he or she were still living). As noted above, this provision is contrary to the previously widely accepted interpretation of the SECURE Act.

Effective Date

At this time, the regulations are not final, and accordingly, these rules are not yet the law. The IRS is accepting comments on the proposed regulations through the end of May, and we anticipate seeing final regulations before the end of 2022.

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