ADVANCED PLANNING

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Insights & Ideas

New Proposed Regulations from the IRS Modify the "Stretch" IRA Rules for Retirement Accounts Once Again

When the Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act) was signed into law in December of 2019, it ushered in significant changes to the rules for retirement accounts and effectively changed the way financial professionals helped clients prepare for retirement. Although the Act featured numerous provisions, Congress made a significant modification to the "stretch" IRA rule. In the two years since the passage and enactment of the SECURE Act, practitioners believed the resulting outcome to the "stretch" IRA strategy was understood, but new proposed regulations from the IRS released in late February modified the rules once again.

The End of the "Stretch" IRA

Prior to the passage of the SECURE Act, the "stretch" IRA was a popular legacy planning strategy for non-spouse beneficiaries who inherited retirement accounts. By leveraging this strategy, non-spouse beneficiaries were able to defer distributions and spread the tax liability of an inherited retirement account over the course of their life expectancy. The SECURE Act changed this by generally requiring beneficiaries of retirement accounts to completely withdraw inherited traditional IRAs and tax-qualified retirement plans by December 31 of the year of the tenth anniversary of the account holder's death and pay the resulting tax liability. The only beneficiaries that could continue to "stretch" were those who meet the criteria to be considered an Eligible Designated Beneficiary.[1]

Defining and Refining the Provisions

The actual text of the SECURE Act legislation doesn't explicitly define all of the rules and resulting effects of the new provisions. In some instances, the provisions as written are left open to interpretation by the IRS, leaving the financial services community waiting for more details and clarity to come in the form of Treasury Regulations.

With respect to the provision that modified the "stretch" IRA rules, at the enactment of the SECURE Act, the general understanding of practitioners was that the 10-Year Rule only required the inherited account to be fully distributed by the end of the tenth year after the death of the account holder. In years one through nine, the beneficiary could choose to take any amount as a distribution, or even elect to take no distributions at all, allowing the money to stay in a tax-deferred status.

That general understanding of the rule was first called into question in 2021 when the IRS released its annual update to Publication 590-B Distributions from Individual Retirement Arrangements (IRAs). Within this update, there was an example that appeared to indicate that non-Eligible Designated Beneficiaries did have required minimum distributions (RMDs) that needed to be taken from the inherited account every year until year 10 when account needed to be fully distributed. This sparked considerable discussion among the financial community, resulting in the IRS issuing a response that suggested a mistake had been made in the publication. The IRS later followed with a revised version of the publication, which brought relief to practitioners as it seemed to validate that their original interpretation was correct: under the 10-Year Rule, the only required distribution from an inherited retirement account for a non-Eligible Designated Beneficiary is in year 10 when the account needs to be emptied.

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The IRS Changes Course – New Proposed Regulations

On February 24, 2022, the IRS issued proposed regulations, which seemingly reverses last year's stance. In these new proposed regulations, the IRS distinguished between non-Eligible Designated Beneficiaries who inherit a retirement account from an account owner who died before the account owner's Required Beginning Date and non-Eligible Designated Beneficiaries who inherit a retirement account from an account owner who died after the account owner's Required Beginning Date. Under these new proposed regulations:

- Non-Eligible Designated Beneficiaries who inherit a retirement account from an account owner who died before the account owner's Required Beginning Date would only be subject to the 10-Year Rule as originally understood, meaning these beneficiaries would not be required to take any distributions from the account until the tenth year when the account needs to be completely emptied.
- Non-Eligible Designated Beneficiaries who inherit a retirement account from an account owner who died after the account owner's Required Beginning Date are subject to the 10-Year Rule, but required to take life expectancy RMDs from the account in years one through nine.

Should these new IRS proposed regulations be finalized without further amendments, this change would add a new complexity to how financial professionals work with clients to create financial plans that achieve their retirement and legacy objectives.

How to Help Clients Plan

Keep in mind that the proposed regulations are effective as of January 1, 2022. Nevertheless, these regulations may be further amended before being finalized, and without finalized regulations, any changes made to a client's plan or strategy may be premature. Staying current on the proposed regulations, any amendments made, and news of their finalization will ensure the plans you're building with clients achieve their desired objective.

Beyond the change to the 10-Year Rule, the recently proposed regulations also included clarification on how to document an Eligible Designated Beneficiary, as well as new information on the rules regarding when a trust is a beneficiary of a retirement account. These aspects of the proposed regulations will be discussed in a future edition of Advanced Planning Insights & Ideas.

For help in understanding any aspect of the proposed regulations or creating a strategy to help your client meet their retirement and legacy goals, please contact Advanced Planning at 800-800-2738, option 4.

[1] *Eligible Designated Beneficiaries are individuals who fall into one of the following five categories: surviving spouse of the account owner, minor child of the account owner (younger than age 21), disabled individual, chronically ill individual, or any individual who is not more than 10 years younger than the account owner.*

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