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Retirement Planning

How New RMD Regulations Affect a Key Category of Beneficiaries

The IRS has finalized new rules covering required minimum distributions from retirement plans for non-eligible designated beneficiaries. Here are the details.

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On July 18, 2024, more than two years after releasing its proposed regulations applicable to required minimum distributions (RMDs), the IRS released its final RMD regulations. These final regulations amend the rules and regulations governing RMDs from qualified retirement plans, 401(k) plans, governmental 457(b) plans, and individual retirement accounts (IRAs) to reflect changes made by the Secure Act of 2019.

The Secure Act of 2019 (Secure Act 1.0) brought massive changes to the payout rules applicable to inherited 401(k) plans and IRAs. The most significant change was the elimination of the "stretch" IRA for most non-spouse beneficiaries referred to as a Non-Eligible Designated Beneficiary (NEDB) and replaced it with a new 10-year payout rule.

Secure Act 1.0 created a new category of beneficiary—Eligible Designated Beneficiary (EDB). Now there are three categories of beneficiaries—each classification has its own unique set of RMD rules.

(1) NEDB: Any individual designated as a beneficiary. A NEDB excludes nonperson beneficiaries such as estates, charities, and certain trusts. Rules covering NEDBs will be the focus of this column.

(2) EDB: There are five types of EDBs including: surviving spouse, minor child of the account owner, disabled beneficiary, chronically ill beneficiary, and a beneficiary that is not more than 10 years younger than the account owner. Generally, an EDB can take minimum distributions based of their single life expectancy. We will explore rules applicable to EDBs in a future column.

(3) Non-Designated Beneficiary: A beneficiary without a life expectancy such as an estate, charity, or non-qualified trust. We covered this category in an August 2024 column.

This new 10-year rule referenced above requires a NEDB to fully liquidate the inherited account by the 10th year following the year of the retirement account owner's death.

Initially, this new payout timeline seemed straightforward. It was assumed to work just like the five-year rule that applies to a non-designated beneficiary, except the payout is 10 years (instead of five years). The NEDB would not be required to take annual minimum distributions during the 10-year payout window. Instead, the NEDB had the flexibility to take income (as little or as much) as needed annually over the 10-year period.

Enter the IRS.

In February 2022, the IRS issued its proposed RMD regulations that include provisions from Secure Act 1.0, which included a surprise interpretation of the 10-year rule. These proposed regulations created a two-tier system for NEDBs: (1) those NEDBs who inherited a retirement account from the original owner who died *before* their required begin date (RBD) for RMDs and (2) those NEDBs who inherited a retirement account from the original owner who died *on or after* their RBD for RMDs. More specifically the regulations stated:

- A Non-EDB who inherited a retirement account from an owner who died before their RBD only needs to exhaust the inherited account by the end of the 10th year after owner's death. In other words, the NEDB is not subject to annual minimum distributions during the 10-year window.
- A Non-EDB who inherited a retirement account from an owner who died *on/after* their RBD are subject to both the 10-year rule and minimum distributions rules. Here a NEDB must take annual RMDs in years 1–9, with all remaining amounts distributed by the end of the 10th year after the account owner's death. Notably, the IRS based its interpretation on a provision in the tax code referred to as "at least as rapidly rule." This rule requires annual RMDs to continue once they have started.

Required Begin Date

The required begin date is the date at which a retirement account owner must begin taking RMDs. For IRA owners, this date is generally April 1 of the year following the calendar year in which an IRA owner reaches *their applicable age*. Applicable Age is based on a participant or IRA owner's year of birth.

Secure Act 2.0 provided for multiple increases in the age at which lifetime RMDs must begin, thus creating multiple possible ages at which RMDs begin (i.e., age 70½, 72, 73, or 75). The age at which the RMD begins is based on participant's date of birth.

RMD Beginning Ages

- Individuals born before July 1, 1949: age 70½
- Individuals born on or after July 1, 1949, but before January 1, 1951: age 72
- Individuals born in 1951 through 1958: age 73
- Individuals born *in* 1959: 73. Importantly, Secure Act 2.0 contained an error for those retirement owners born in 1959. The text stated those born in 1959 have an applicable age of both age 73 and 75! The IRS has issued proposed regulations for an applicable age of 73 for those individuals born in 1959.
- Individuals born *after* 1959: 75

Notably, a 401(k) plan participant's RBD may differ, due to the "still working exception" rule. This rule allows a participant in a 401(k) plan to delay their RMD until April 1 of the year following the year of retirement if they are working (for the employer sponsoring the plan). This rule, however, is not available to those participants who own more than 5% of the company, nor does it extend to IRAs.

The final regulations issued by the IRS on July 18, 2024, followed their proposed regulations and upheld the controversial requirements (discussed above) satisfying the 10-year rule based on when the original retirement account died—before or on/after their RBD for RMDs.

EXAMPLE 1: Donna dies in 2024, at age 80, with a traditional IRA. Her son Frank, age 40, is a non-Eligible Designated Beneficiary. Since Donna died after her RBD for RMDs, Frank must take RMDs from the inherited IRA using his single life expectancy in years 1-9 (2025-2033).

Frank's first RMD in 2025 (year after Donna's death) is based on his single life expectancy of 44.8 and the prior year (2024) account balance of, let's say, $200,000. Frank's initial RMD would total $4,464 ($200,000/44.8). Each year thereafter Frank subtracts "1" from remaining single life expectancy (43.8, 42.8, 41.8, etc.). The remaining balance, if any, in the inherited IRA must then be distributed by December 31, 2034.

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What to know about determining RMDs during the 10-year payout window

- Beneficiary uses his/her own single life expectancy determined by the IRS Single Life Expectancy Table. The single life expectancy is based on the beneficiary's age in the year *after* the year of the IRA owner's death.
- The first year RMD (i.e., year 1) is due by December 31 of the year following the year of the account owner's death.
- The final regulations impact the calculation of RMDs from 401(k) plans, IRAs, 403(b)s and governmental 457(b) plans.

The Roth IRA Advantage

The owner of a Roth IRA is not subject to lifetime RMDs and therefore does not have an RBD. The IRS in the final regulations confirm that every deceased Roth IRA owner is deemed to have died before his or her RBD, regardless of their age at death. Even though a NEDB of a Roth IRA owner is subject to the 10-year rule, the inherited Roth funds are not subject to annual minimum distributions. Instead, such funds continue to accumulate tax deferred for the full 10-year period. The entire balance of the inherited Roth must still be withdrawn by the end of the 10th year after death—but such a distribution would be tax free!

EXAMPLE 2: Dan dies in 2024, at age 85, with a Roth IRA. His son Thomas, 50, is a NEDB. Even though Dan died at 85, he is deemed to have died before his RBD. Therefore, Thomas is not required to take minimum distributions in years 1-9. Instead, he can allow the inherited Roth fund to accumulate tax deferred over the course of his 10-year payout window (2025-2034)

Thomas must still exhaust the balance (if any) by December 31, 2034, but importantly, the distribution would be tax free.

One Final Consideration

IRS Final RMD Regulations apply for distribution calendar years beginning on or after January 1, 2025. However, the IRS will not impose penalties for annual RMDs that were not taken for years before 2025.

EXAMPLE 3: Brandon, age 48, inherited a traditional IRA from Terry, his mother, who died in 2020 at age 78 (after her RBD). Brandon, as a NEDB, is subject to the 10-year rule. He must fully liquidate the inherited IRA account by December 31, 2030. The final regulations require Brandon to take annual RMDs based on his single life expectancy in years 1-9 of the 10-year payout. Notably, due to IRS guidance waiving the RMD penalty in years 2021, 2022, 2023, and 2024, Brandon does not need to take the annual RMD for these years. He does, however, need to take an RMD in 2025. Furthermore the 10-year deadline was not extended— thus Brandon must fully liquidate the inherited IRA by December 31, 2030.

Questions? Please contact your Lord Abbett representative at 888-522-2388.

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A 401(k) plan is a qualified plan that includes a feature allowing an employee to elect to have the employer contribute a portion of the employee's wages to an individual account under the plan. The underlying plan can be a profit-sharing, stock bonus, pre-ERISA money purchase pension, or a rural cooperative plan. Generally, deferred wages (elective deferrals) are not subject to federal income tax withholding at the time of deferral, and they are not reported as taxable income on the employee's individual income tax return. A safe harbor 401(k) plan is similar to a traditional 401(k) plan, but, among other things, it must provide for employer contributions that are fully vested when made.

A 457(b) deferred compensation plan is a type of tax-advantaged retirement savings account that certain state and local governments and tax-exempt organizations offer employees.

A Roth IRA is a tax-deferred and potentially tax-free savings plan available to all working individuals and their spouses who meet the IRS income requirements. Distributions, including accumulated earnings, may be made tax-free if the account has been held at least five years, and the individual is at least 59½, or if any of the IRS exceptions apply. Contributions to a Roth IRA are not tax-deductible, but withdrawals during retirement are generally tax-free.

A Traditional IRA is an individual retirement account (IRA) that allows individuals to direct income, up to specific annual limits, toward investments that accumulate tax-deferred. Contributions to the traditional IRA may be tax-deductible depending on the taxpayer's income, tax-filing status, and other factors.

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