

# IRA Masterclass

## Session 3: Guide to Avoiding Tax Traps for Beneficiary Distributions from IRAs and Employer- Sponsored Retirement Plans

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With: Denise (**The IRA Whisperer**) Appleby MJ, CISP, CRC, CRPS, CRSP, APA



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Denise Appleby is a nationally recognized author, expert, trainer, speaker, and consultant on IRAs and employer plans for small businesses. She helps financial, tax, and legal professionals avoid mistakes with their clients' retirement accounts and, where possible, fix mistakes.

Due to her knack for helping even the most resistant IRA custodians correct IRA mistakes and resolve other complex IRA-related issues, Denise has earned the reputation of being “The IRA Whisperer”.

Denise graduated from John Marshall Law School, where she obtained a Master of Jurisprudence in Employee Benefits and has earned several professional designations for IRAs and employer plans.



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# Learning Objectives

**At the end of the session, participants should be able to:**

- 🍏 Identify the different types of beneficiaries
- 🍏 Know the distribution options available to beneficiaries
- 🍏 Identifying tax-efficient strategies for beneficiaries
- 🍏 Understand the penalty that could apply when beneficiaries do not meet distribution deadlines and when such penalty could be waived

# The IRA Tea! Updates & Reminders 🍏

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# SECURE Act 1.0

**Dec. 20, 2019**

**Public Law No: 116-94**

# SECURE Act Highlights for RMDs

- 🍏 increased RMD starting age from 70 ½ to 72
- 🍏 added eligible designated beneficiaries after 2019
- 🍏 made life expectancy distributions for accounts inherited after 2019 available only to eligible designated beneficiaries
- 🍏 introduced 10-year maximum rule for successor beneficiaries of life expectancy beneficiaries (**killed the stretch**).

# SECURE Act Language | Designated Beneficiaries

- (i) In general. --Except in the case of a beneficiary who is not a designated beneficiary, subparagraph (B)(ii) -- `(I) shall be applied by substituting `10 years' for `5 years', and **``(II) shall apply whether or not distributions of the employee's interests have begun in accordance with subparagraph (A).**
- (ii) Exception for eligible designated beneficiaries.



# Proposed Regulations Shake Up Industry

Annual RMDs required when IRA owner dies  
on/after the RBD

**A**t **L**east **A**s **R**apidly (ALAR) rule still applies

# The A.L.A.R. Plus the 10-Year Rule

**Means annual RMDs for some 10-year beneficiaries**

# Waiver of Excise Tax For RMDs under SECURE Act 10- year rule.

- 🍏 Notice 2022-53: 2021 and 2022
- 🍏 Notice 2023-54: Extended to 2023
- 🍏 Notice 2024-35 : Extended to 2024





**Owner dies after 12/31/2019**

**Death on/after the RBD (N/A for Roth IRAs)**

 **10-Year rule PLUS**

 **Annual RMDs**

## Owner dies after 12/31/2019

🍏 Successor beneficiary of Eligible designated beneficiary who **was taking life expectancy distributions**

🍏 Eligible designated beneficiary includes pre-2020 designated beneficiaries

Successor  
Beneficiaries  
of Eligible  
Designated  
Beneficiaries

# Caution: RMDs not Waived

- 🍏 Only the excise tax is waived. RMDs are not waived
- 🍏 Caution: Rollover from employer plans to IRA may not include RMDs

IRS final RMD  
regulations July  
19, 2024.

Incorporate  
rules from

- SECURE Act
- and
- SECURE 2.0.



# 10-Year Period Not Extended!

# **Catch-Up of RMD not Applicable!**



**No Documentation for IRA custodians  
See-Through Trust Documentation**



**No Documentation Required for EDB of IRAs**



# Older EDB Safe from Their Own LE

- 🍏 Proposed RMD Regulations required post RBD older Eligible Designated Beneficiary to end distributions by end of owner's single life expectancy
- 🍏 Final RMD regulations remove restriction



# Spouse Treat as own Deadline Removed

🍏 Proposed: Deadline is the later of:

- (1) the end of the calendar year in which the surviving spouse reaches applicable age, and
- (2) the end of the calendar year following the calendar year of the IRA owner's death.

surviving spouse still would be permitted to roll over distributions to the spouse's own IRA except for hypothetical RMDs

🍏 Final regulations **excluded the deadline from its language**

🍏 Hypothetical RMD rule still apply

# Hypothetical RMD Remains for Spouse Beneficiaries

 Spouse beneficiary is subject to 10-year rule.

 Spouse switches to life expectancy option.

 Rollover cannot include hypothetical RMDs.

- RMDs that would have been due, had the life expectancy option been elected.

# SECURE Act 2.0

🍏 Division T of the “Consolidated Appropriations Act, 2023”

🍏 Dec. 29, 2022

🍏 Public Law No: 117-328



# SECURE Act 2.0

- 🍏 Introduced new schedule for applicable age (age to start RMD)
- 🍏 Modified some RMD rules
- 🍏 Repealed RMD for participants in designated Roth accounts
- 🍏 Reduced excise tax on RMD shortfalls

Proposed  
regulations July  
19, 2024.

• SECURE  
2.0.



# New RMD Ages: 1959 YOB Now Proposed

Year/date of birth	Applicable age When RMDs begin
June 30, 1949, and earlier	The year they attained age 70½
July 1, 1949–December 31, 1950	The year they attained age 72
January 1, 1951–December 31, 1958	The year they attain age 73
January 1, 1959–December 31, 1959	The year they attain age 73*
January 1, 1960, and after	The year they attain age 75
The First RMD must be taken by April 1 of the year after the Applicable RMD Age.	
* SECURE Act 2 proposed regulations	

# Spousal Election : Section 327

 Proposed

 More about this later

# Benefits Available to Inherited Accounts

- 🍏 Continued pre-SECURE Stretch for certain beneficiaries
- 🍏 Continued tax-deferral for limited periods
- 🍏 Rollover eligibly for inherited employer plans
- 🍏 Roth conversion opportunity for employer plans
- 🍏 Multiple options = flexibility for spouse beneficiaries

# Beneficiary Options? You need all the facts!

Missing data could mean  
incorrect results for beneficiary  
RMDs



# Must Know Rules for Getting Beneficiary Distributions Right

🍏 Did death occur before 2020?

🍏 Did death occur before the RBD?

🍏 Is the account a Roth?

🍏 What class does the beneficiary fall under?

# Create a Beneficiary Questionnaire

**Get the  
information  
required to  
determine  
beneficiary  
Options**

Date of birth of the IRA owner

Date of death of the IRA owner

Date of birth of beneficiary

Whether beneficiary is surviving spouse of IRA owner

Whether beneficiary is disabled or chronically ill

Whether there are multiple beneficiaries, and if so:

- which of the above applies to each
- Which ones can be disregarded (September 30 deadline)
- Whether separate accounting occurred by the deadline (December 31)

Whether the beneficiary is a successor beneficiary



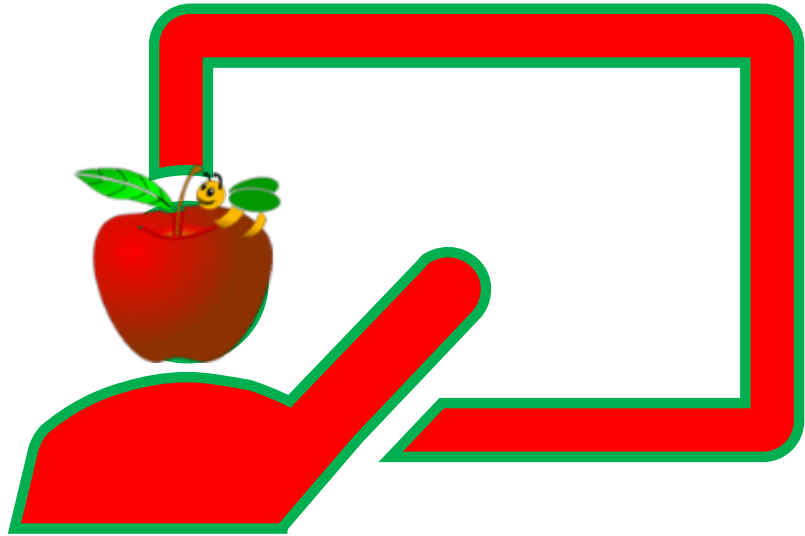
# Beneficiary Options

Multiple options in most  
cases

# Roth Beneficiary Rules: Always 'Before RBD'

- 🍏 There is no RMD for Roth account owners
- 🍏 Roth IRA Beneficiaries are treated as inheriting account from someone who died *before* the RBD

# Appleby's Practice Pointer



## RMD for Year of Death

- 🍏 Must be taken by the end of the year to avoid penalty
- 🍏 If Account Owner dies in RMD Year:
  - Beneficiary must take owner's RMD, if not taken by owner
  - If taken after owner's death:
    - Must be reported on 1099-R under beneficiary's TIN
    - Included in beneficiary's income
    - Still calculated as if owner is alive

# RMD for Year of Death- Final RMD Regulations

- 🍏 For Multiple beneficiaries: Can be taken by one or more beneficiaries
- 🍏 For Multiple IRAs: prorated among IRAs

# RMD for Year of Death: Waiver of Excise Tax

- 🍏 Any shortage must be taken by beneficiary
  - 25% excise tax (reduced from 50% under SECURE Act 2.0 2023).
- 🍏 Excise tax automatically waived if distributed by the later of:
  - the beneficiary's tax filing deadline for the year in which the owner /participant died- plus extension, and
  - the end of the following calendar year

# Learning Objective 1

 Identify the different types of beneficiaries

# Classes of Beneficiary


	Pre-SECURE	SECURE	Definition/Comments
<b>Beneficiary</b>	✓	✓	<ul style="list-style-type: none"> <li>✓ Any party that inherits an IRA</li> <li>✓ Named on the beneficiary form or determined to be the beneficiary under the terms of the plan document</li> </ul>
<b>Designated Beneficiary</b>	✓	✓	<ul style="list-style-type: none"> <li>✓ A beneficiary who is an individual</li> </ul>
<b>Eligible Designated Beneficiary</b>	X	✓	<p>A designated beneficiary who is either of the following:</p> <ol style="list-style-type: none"> <li>1. The surviving spouse of the IRA owner</li> <li>2. A child of the IRA owner who has not reached age 21</li> <li>3. Disabled within the meaning of section 72(m)(7)</li> <li>4. Chronically ill within the meaning of section 7702B(c)(2), subject to certain exceptions</li> <li>5. Not more than 10 years younger than the IRA owner</li> </ol> <p><b>Determined at the time of the IRA owner's death</b></p>
<b>Nondesignated Beneficiary</b>	✓	✓	<ul style="list-style-type: none"> <li>✓ Any beneficiary that is not a designated beneficiary (a non-individual)</li> </ul>
<b>Successor Beneficiary</b>	✓	✓	<ul style="list-style-type: none"> <li>✓ Beneficiary who inherits from a beneficiary</li> </ul>

# Minor as Beneficiary

Final RMD Regulations defines a minor child as:-

 a stepchild,

 an adopted child, and

 an eligible foster child - a foster child placed with the IRA owner by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction

# Determine EDB Status at the time of death

## Why?

🍏 Becoming disabled or chronically ill after death does not count

# Date of Birth Determines NMTTTY

 Date of birth determines **Not More Than Ten Years Younger**

**Example:** Susie's date of birth is October 1, 1953

Susie's beneficiary is not more than 10-years younger, if the beneficiary born on or before October 1, 1963.

Includes beneficiaries older than IRA owner

# Learning Objective 2 🍏

🍏 Know the distribution options available to beneficiaries



# The Determinant Question & Answer

Are you the  
primary  
beneficiary?



YES!



Status: IRA Owner Dies  
Client is primary beneficiary



# Follow-Up Questions

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🍏 Did the owner die before 2020?

🍏 Did the owner die before the RBD?

















🍏 What is beneficiary's class?



# RBD is April 1 after Applicable RMD Year

Year/date of birth	Applicable age When RMDs begin
June 30, 1949, and earlier	The year they attained age 70½
July 1, 1949–December 31, 1950	The year they attained age 72
January 1, 1951–December 31, 1958	The year they attain age 73
January 1, 1959–December 31, 1959	The year they attain age 73*
January 1, 1960, and after	The year they attain age 75
The First RMD must be taken by April 1 of the year after the Applicable RMD Age.	
* SECURE Act 2 proposed regulations	

# Beneficiary Options: Pre-Secure Act & SECURE Act

	Pre-SECURE: IRA owner dies 12/31/2019 or earlier		SECURE: IRA owner dies after 12/31/2019	
	Death before the RBD	Death on/after the RBD (N/A Roth IRA)	Death before the RBD	Death on/after the RBD (N/A Roth IRA)
<b>Designated Beneficiary</b>	 5-year rule  Beneficiary's life expectancy	 Longer of Beneficiary's or decedent's life expectancy	 10-year rule	 Beneficiary's life expectancy &  10 Year rule
<b>Eligible Designated Beneficiary</b>	 N/A	 N/A	 Beneficiary's life expectancy or  10 Year rule	 Longer of Beneficiary's or decedent's life expectancy
<b>Nondesignated beneficiary</b>	 5-year rule	 Decedent's life expectancy	 5-year rule	 Decedent's life expectancy
 Life expectancy ends at age 31 for minor child of IRA owner <b>IRC § (a)(9)(E)(iii)</b>				



# The Determinant Question & Answer

Are you the  
primary  
beneficiary?





No!



# Status: Beneficiary Dies

## Client is successor beneficiary



# Follow-Up Questions





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🍏 Did the owner die before 2020?

🍏 What distribution option applies to the primary beneficiary?



## Pre-SECURE vs SECURE

	Designated Beneficiary Dies Before 2020	Designated Beneficiary Dies After 2019	Eligible designated beneficiary dies. Includes pre-2020 designated beneficiary
Death of Designated Beneficiary	 Successor beneficiary continues to take distributions over designated beneficiary's distribution period	 Successor beneficiary continues to take distributions over designated beneficiary's distribution period	 Successor beneficiary continues to take distributions over designated beneficiary's distribution period  Cannot extend beyond 10-years

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# Successor Beneficiary Options

# Learning Objective 3 🍏

🍏 Identify Tax Efficient Strategies for beneficiaries

# Run Analysis for Tax Impact of 10-year rule

- 🍏 Does it make better tax-sense to still take distributions, despite the waiver?
- 🍏 Consideration: Impact on other benefits
- 🍏 Consideration: Income from other sources



# Tax-Efficient Spreads Under the 10-Year Rule

## Considerations

- 🍏 Should more than RMDs be taken each year?
- 🍏 Special considerations for Roth accounts

# A Case Study!



# A Case Study

- 🍏 10-year schedule
- 🍏 Owner dies on/after RBD
- 🍏 Designated Beneficiary
- 🍏 **The question: Should Only RMDs be taken each year?**

Calculating Minimum Distributions for Qualified Plan or IRA	
Current Year:	2024
Year of First Required Distribution:	2010
12/31/2023 Plan Balance:	\$500,000.00
Expected Plan Growth:	7.0000%
Distributions Taken at Beginning of Each Year	
Is there a Designated Beneficiary?	Yes: Beneficiary
Owner's Birth Date:	1/1/1940
Beneficiary's Birth Date:	1/1/1970
Beneficiary is Spouse?	No
Assumed Death of Owner:	2024
Assumed Death of Beneficiary:	Never

# RMD Only = Huge Amount in Year 10

Year	Age	Balance	Life Exp.	Distribution	Total Distributed
<b>2024</b>	<b>84</b>	<b>\$500,000.00</b>	<b>16.8</b>	<b>\$29,761.90</b>	<b>\$29,761.90</b>
<b>2025</b>	55	\$503,154.77	31.6	\$15,922.62	\$45,684.52
<b>2026</b>	56	\$521,338.40	30.6	\$17,037.20	\$62,721.72
<b>2027</b>	57	\$539,602.28	29.6	\$18,229.81	\$80,951.53
<b>2028</b>	58	\$557,868.54	28.6	\$19,505.89	\$100,457.42
<b>2029</b>	59	\$576,048.04	27.6	\$20,871.31	\$121,328.73
<b>2030</b>	60	\$594,039.10	26.6	\$22,332.30	\$143,661.03
<b>2031</b>	61	\$611,726.28	25.6	\$23,895.56	\$167,556.59
<b>2032</b>	62	\$628,978.87	24.6	\$25,568.25	\$193,124.84
<b>2033</b>	63	\$645,649.36	23.6	\$27,358.02	\$220,482.86
<b>2034</b>	<b>64</b>	<b>\$661,571.73</b>	<b>0.0</b>	<b>\$661,571.73</b>	<b>\$882,054.59</b>
<b>Total</b>				\$882,054.59	

# A Case Study!



# A Case Study

🍏 10-year schedule vs life expectancy

🍏 Owner dies before RBD

🍏 Eligible Designated Beneficiary

🍏 **The question: Which Option should be elected?**

Calculating Minimum Distributions for Qualified Plan or IRA	
Current Year:	2024
Year of First Required Distribution:	2025
12/31/2023 Plan Balance:	\$500,000.00
Expected Plan Growth:	7.0000%
Distributions Taken at Beginning of Each Year	
Is there a Designated Beneficiary?	Yes: Beneficiary
Owner's Birth Date:	1/1/1970
Beneficiary's Birth Date:	1/1/1969
Beneficiary is Spouse?	No
Assumed Death of Owner:	2024
Assumed Death of Beneficiary:	Never

# Eligible Designated Beneficiary: Owner dies Before RBD

 **The 10-Year Rule:** Assuming spread equally over 10-Years: **\$739,179.97**

 **The 10-Year Rule:** Assuming lump-Sum in year 10: **\$983,575.68**

 **Life Expectancy Rule:** Taking Only RMDs: **\$1,731,374.30**

See handout for detailed illustration

# Override the 10-Year Default

🍏 Allows for stretch over full life expectancy



# Overriding the 10-Year Rule: Case Study : Slide 2 of 2

🍏 60-year-old Jane's brother died in 2023 at age 65, leaving her a 401(k) valued at \$500,000.

🍏 Because she is an eligible designated beneficiary, Jane has two options:  
**(a)** the life expectancy option, and **(b)** the 10-year rule, because she is an eligible designated beneficiary.

# Overriding the 10-Year Rule: Case Study: Slide 1 of 2

🍏 The 401(k) plan defaults to 10-years. If Jane wants to use the life expectancy method, Jane must rollover the 401(k) to a beneficiary IRA that allows her to use the life expectancy option by 12/31/2024.

# Planning Opportunities for Spouse Beneficiaries



# Tax Mitigation Strategies for Spouse Beneficiaries

 If under age 59 ½:

- Leave in a beneficiary IRA or beneficiary employer plan account.
- Distributions will be automatically exempt from the 10% early distribution penalty.

 If age 59 ½ and older, look for opportunities to:

- Defer RMDs as long as possible
- Minimize RMDs where possible

 Include considerations for a spouse's successor beneficiaries

# SECURE 2.0 | Section 327

## **Proposed Regulations: Spousal Election Under Section 327 of the SECURE 2.0 Act**

A surviving spouse- **who is the sole beneficiary**- may elect to:

- 1) be treated as if the surviving spouse were the employee for RMD purposes;
- 2) wait until the date the employee would have attained the applicable age to begin taking required minimum distributions; and
- 3) have the beneficiaries of the surviving spouse be treated as beneficiaries of the employee if the surviving spouse dies before distributions to the spouse begin.

# SECURE 2.0 | Section 327

- 🍏 Applies to calendar years beginning 2024
- 🍏 Affect only spouse beneficiaries for whom their first RMD year is 2024 or after.
- 🍏 Account is still a beneficiary account
- 🍏 Plan can default to this rule if participant dies before the RBD and the life expectancy rule applies (no election required)
- 🍏 **Be aware:** Regulations could be modified before becoming final.

# Learning Objective 4 🍏

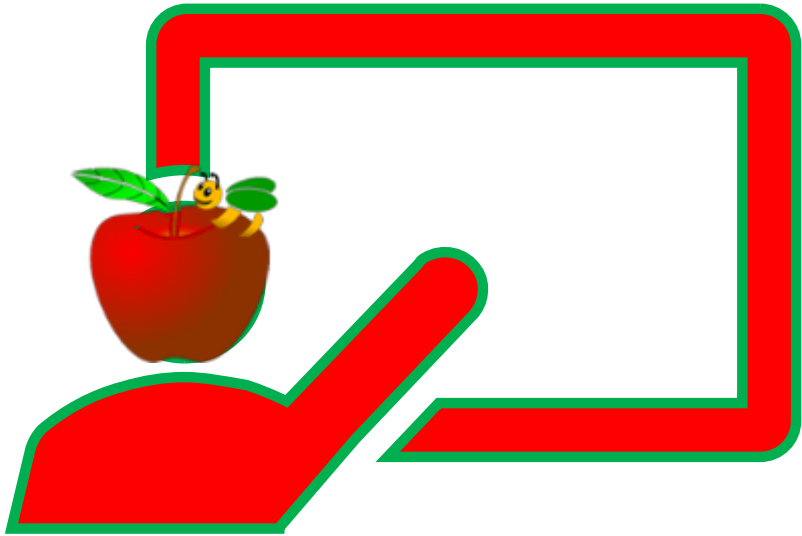
🍏 Understand the penalty that could apply when beneficiaries do not meet distribution deadlines and when such penalty could be waived

# Ensure Moves Preserve Tax Deferral

🍏 Using the 'wrong' method to move an inherited account can cause avoidable tax and penalties.



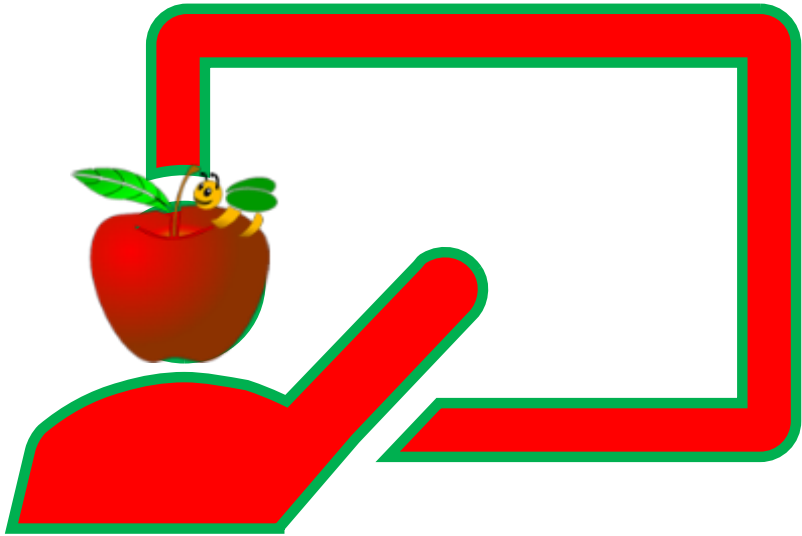
# Appleby's Practice Pointer



**Retain spread options by using  
'transfers' to move inherited IRAs.**

- 🍏 A nonspouse beneficiary may not rollover a distribution from an inherited IRA.
- 🍏 A spouse beneficiary may rollover a distribution from an inherited IRA only to *own* IRA

# Appleby's Practice Pointer



**Retain spread options by using 'direct rollovers' to move inherited Employer plan accounts.**

- 🍏 Only a designated beneficiary may rollover an inherited employer plan account or benefit
- 🍏 A nonspouse beneficiary must use the direct rollover method.
- 🍏 A spouse beneficiary must use the direct rollover method if the rollover is to a beneficiary IRA.
- 🍏 An indirect rollover by a spouse must be made to her own IRA.

# Avoiding the 25% Excise Tax on Excess Accumulation

- 🍏 Taking RMDs by the deadline: IRA owners and Beneficiaries
- 🍏 Missed deadline? Make it up during the **correction window**. Excise tax is reduced to 10%
- 🍏 Reasonable error for missing deadline? File IRS Form 5329

# IRA Inherited in 2018? Last Year to Switch to 5-Year from Life Expectancy and Avoid the excise tax

🍏 IRAs inherited 2018 by designated beneficiaries.

🍏 Owner died before the RBD.

🍏 Life expectancy applies

🍏 No RMDs taken?

🍏 Excise tax is automatically waived if the beneficiary:

- Did not make an affirmative election to use the life expectancy rule.
- Was subject to the life expectancy rule under the terms of the IRA agreement or RMD regulations.
- Elects for the inherited IRA to be distributed under the five-year rule.
- 2024 is year 5: 2020 not counted

# Key Takeaways

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- 🍏 Profile beneficiary to determine options
- 🍏 Look for opportunities for tax efficient distribution strategies.
- 🍏 Request waivers for RMD shortfall.



# Questions?



**Send them to** [Training@DeniseAppleby.com](mailto:Training@DeniseAppleby.com)



**Thank you  
for your  
attention and  
your time!**

