New Tax Rules Force Faster Payouts for Some IRA Holders

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By [Laura Saunders]
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It used to be that Americans with tax-favored retirement plans focused mainly on how to get money into them. Now, savers are more and more concerned with how much must be withdrawn, and when—including at death or after.

“Virtually all affluent families—as opposed to very wealthy ones—now have significant assets in retirement plans, and it’s essential to focus on them when doing estate planning,” says Natalie Choate, an attorney in Wellesley, Mass., who specializes in retirement plans.

Total assets in traditional and Roth individual retirement accounts, 401(k)s and similar tax-sheltered retirement vehicles grew to $22 trillion in 2020 from $3 trillion in 1995, according to the Investment Company Institute.

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These accounts have swelled from new contributions and market growth as traditional pensions have waned, and many savers now hold a large percentage of their assets in them. Often portions of these accounts are left intact to heirs, who can withdraw the assets over time and benefit from the tax deferral they provide.

Now there's new guidance from the Internal Revenue Service on required withdrawals for heirs of these accounts. The proposed regulations, issued in late February, would speed up required payouts and add paperwork for many heirs of traditional IRAs but not for heirs of Roth IRAs. They also won't affect most spouses who inherit retirement accounts.

The new IRS rules fill in details of the Secure Act, a law Congress passed in 2019 that revised rules for retirement plans. One of its changes greatly sped up required withdrawals for many retirement-plan heirs, enraging IRA owners who had made

estate plans based on prior law. The faster money has to come out of retirement accounts, the less tax-deferred growth there is.
Here's what IRA owners doing estate planning need to know about the proposed rules.

New annual withdrawals for some heirs

The Secure Act said that many heirs of traditional and Roth IRAs (and similar accounts) whose owners died after 2019 must empty the accounts within 10 years—not over decades as under prior law.

This rule does not apply if the heir is a spouse, someone less than 10 years younger (often a sibling) or a disabled individual. For minor children (but not grandchildren) who are heirs, the 10-year term doesn't begin until the heir turns 21. Until the term begins, the heir who is a minor child will also have to take some annual payouts required by the law. These are likely to be small.

Although the Secure Act's wording was vague, prominent IRA specialists assumed for several reasons that affected heirs could wait until the 10th year before taking any payouts.

Instead, the new IRS guidance would require heirs subject to the 10-year rule to take annual withdrawals from the accounts during that period if the original owner died on or after his or her "required beginning date" for payouts. Under current law, that's April 1 after the year in which the IRA owner turns 72.

For example, say that a 50-year-old inherits a traditional IRA from her 77-year-old mother, who died early this year. According to the new rules, this heir must take annual IRA payouts based on her life expectancy as prescribed in IRS Pub. 590-B. Then she must withdraw the remainder when she's 60. (She could, of course, take larger withdrawals earlier.)
While such payouts could be relatively small for a young heir, they add paperwork, and not taking them could incur stiff penalties.

No annual withdrawals for some other heirs

Under the new rules, heirs who are subject to the 10-year withdrawal requirement don't have to take annual payouts during that period if the IRA owner died before reaching his or her "required beginning date" as described above.

For example, if a 15-year-old inherits a traditional IRA from a grandfather who died at age 71, then this heir can wait until the end of the 10th year to drain the account.

There's a twist if a traditional IRA owner dies before his or her April 1 required beginning date. Even if the original owner has already taken a payout at age 72, the heirs subject to the 10-year rule don't have to take annual payouts—because the original owner never reached his or her required beginning date.

The IRS's focus on the required beginning date brings some good news for people who inherited Roth IRAs after 2019. Roth IRA owners aren't required to take annual payouts, so the heirs don't have to take payouts until the end of the 10-year period.

A change to the age of majority

Under the Secure Act, minor children (not grandchildren) who inherit a traditional or Roth IRA can delay the start of the 10-year payout clock until they reach the "age of majority."

This age is 18 in many but not all states. To be consistent—and a bit generous—the IRS rules deem the age of majority to be 21. At that point, the 10-year clock starts to run.

Relief from the 50% penalty for the owner's last payout

Many heirs forget to take a required IRA payout the year the account owner dies, a responsibility that falls on them rather than the executor if the owner didn't take one before death.

In such cases, the new rules grant a waiver of the stiff 50% penalty if the heir takes the missing payout by the due date of their tax return, including extensions, for the year the payout was missed.

The road ahead

The IRS is accepting comments on the proposed rules through May 25 and will issue final guidance later. In the meantime, retirement-account specialist Ed Slott advises holding off on missed 2021 payouts for years one through nine until the IRS issues a clarification on retroactivity, which he hopes will come by the end of 2022.

He warns, “Right now, people don’t know what to do.”

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Corrections & Amplifications
Natalie Choate is an attorney specializing in retirement plans in Wellesley, Mass. An earlier version of this article incorrectly said she was with Nutter, McClennen & Fish. (Corrected on March 11)

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