

Beneficiary payout rules for IRAs and nonqualified annuities after the SECURE Act

UPDATED FOR:

- PROPOSED REGULATIONS PUBLISHED IN FEBRUARY 2022
- REVENUE NOTICE 2022-53 PUBLISHED IN OCTOBER 2022
- SECURE ACT 2.0 FROM DECEMBER 2022
- REVENUE NOTICE 2023-54 PUBLISHED IN JULY 2023
- REVENUE NOTICE 2024-35 PUBLISHED IN APRIL 2024
- PUBLICATION DATE OF THIS VERSION OF THIS PAPER IS APRIL 2024

Thomas H Duncan, JD, CLU, ChFC
Senior Director, Advanced Consulting Group
Nationwide Retirement Institute

EVOLVING NATURE OF THE SECURE ACT'S BENEFICIARY PAYOUT RULES – HIGHLIGHTS OF ONGOING REGULATORY ACTION

SECURE Act 1.0 – December 2019

The Setting Every Community Up for Retirement Enhancement (SECURE) Act passed in late 2019 and brought many changes to all the types of IRAs and qualified retirement plans. One of the most significant changes was to the beneficiary payout rules for these types of retirement savings accounts.

Proposed Treasury Regulations – February 2022

The Internal Revenue Service (IRS) issued proposed regulations in February 2022 attempting to clarify many of the beneficiary payout provisions of the SECURE Act legislation. Final regulations are now expected in late 2024 or 2025.

Revenue Notice 2022-53 – October 2022

Revenue Notice 2022-53 was published in October 2022 clarifying certain aspects of the proposed regulations on beneficiary payout rules.

The notice specifically states that the required minimum distributions (RMD) explained in the proposed regulations that must be taken by beneficiaries for years 2021 and 2022, where an IRA owner or plan participant died in 2020 or 2021 and on or after their required beginning date (RBD) for RMDs, which is April 1 of the year following the year the owner reached RMD age, will not be assessed the 50% excise tax on missed RMDs.

SECURE Act 2.0 – December 2022

The legislation commonly referred to as SECURE Act 2.0 was signed into law on December 29, 2022. This new legislation made changes affecting both owner and beneficiary distributions from IRAs and qualified retirement accounts. Some of these changes are:

- **Reduces the penalty for failure to take RMDs** from 50% to 25%, and potentially 10% – effective on December 29, 2022
- **Created new spousal inheritance option, effective beginning in 2024** – election to be treated as the owner for certain provisions.
- **Changed the owner’s starting age for RMDs, effective in 2023 and beyond:**
 - **75** for those born in 1960 or later
 - **73** for those born from January 1, 1951, to December 31, 1959
 - Please note that RMDs are already required for owners born on or before December 31, 1950, and must continue every year thereafter

Revenue Notice 2023-54 – July 2023

Pushed the annual payment requirement for beneficiaries subject to the 10-year rule where the IRA owner died on or after their RBD to 2024 by eliminating any penalties for failing to take those RMDs for 2023.

Revenue Notice 2024-35 – April 2024

Further pushes the annual payment requirement for beneficiaries subject to the 10-year rule where the IRA owner died on or after their RBD to 2025 by eliminating any penalties for failing to take those RMDs for 2024. The notice also indicated that the rules in the proposed regulations would apply no earlier than 2025.

Effect on nonqualified annuities - none

Finally, it is important to note that SECURE Act 1.0, proposed regulations, and SECURE Act 2.0 **did not** change the beneficiary payout rules for nonqualified annuities.

What Happens Next

The final regulations are not expected to differ significantly from the proposed regulations, especially regarding the annual payout requirements that will be explained throughout this paper.

After Revenue Notice 2024-35 implementation of the annual payment requirement is now set to begin in 2025, so financial professionals should review the IRAs and other qualified retirement accounts of clients who died in 2020 or thereafter to ensure that they are brought into compliance with these new beneficiary payout rules where applicable.

NONQUALIFIED ANNUITY BENEFICIAL PAYOUT RULES AFTER THE SECURE ACT — NO CHANGES

The SECURE Act and its clarifying regulations **did not** change the payout rules for beneficiaries of nonqualified annuities (both deferred and immediate).

Nonqualified deferred annuity payout rules

The nonspouse individual designated beneficiaries of nonqualified deferred annuities may continue to elect to

use their life expectancy to take out their RMDs from the inherited annuity or they can elect to use the 5-year rule.

This life expectancy RMD payout option is commonly referred to as the nonqualified stretch. Alternatively, a nonspouse individual designated beneficiary can annuitize the inherited deferred annuity based on their life or for a term certain period that is less than or equal to their life expectancy. No joint life annuitization payout is permitted to be used in these nonspouse beneficiary payout arrangements. The first life expectancy-based payment (either stretch payment or annuitization) must be taken within 1 year of the owner’s death.

The 5-year payout rule for nonqualified deferred annuities requires that the entire inherited annuity be liquidated within 5 years of the owner’s death. No annual payments are required during the 5-year period.

Trusts and estates are considered non-designated beneficiaries of nonqualified annuities, so only the 5-year rule is available. If a trust or estate is the beneficiary of a nonqualified deferred annuity, the life expectancy payout option is not available.

Example 1 — Death of nonqualified deferred annuity owner

A nonqualified deferred annuity owner dies in 2020. The owner’s daughter is named as beneficiary. The daughter may use her own life expectancy (as determined by the Single Life Table) to take out RMDs over her life expectancy. The first minimum life expectancy based RMD must be taken within 1 year of the owner’s death and then every year thereafter. If the first RMD is not received within 1 year of the owner’s death, or the daughter elects to utilize the 5-year rule to liquidate the inherited annuity, the entire annuity must be distributed within 5 years of the owner’s death with no RMDs required during the 5-year period.

Any gain in the policy will be distributed first and will be taxable as ordinary income to the beneficiary. Distributions from the inherited annuity are not subject to the additional 10% premature distribution tax on pre-59½ distributions, because of the death of the owner.

Nonqualified immediate annuity payout rules

The beneficiaries of nonqualified annuities in payout status can continue to use the selected payout option.

Example 2 — Death of nonqualified immediate annuity owner

An owner purchased a nonqualified immediate annuity with cash in 2020. The first payment was received in 2020. They chose a life with 20-year term certain payout option and named their son as the beneficiary. The owner died in 2022. The son may elect to continue receiving payments for the remaining 18 years of the term certain period or take a commuted value of the remaining payments if permitted by the contract.

IRA BENEFICIAL PAYOUT RULES FOR DEATHS AFTER 2019

10-year rule for designated beneficiaries

The designated beneficiaries of IRA owners who die after December 31, 2019, now have, at most, until December 31 of the 10th calendar year after the IRA owner's death to liquidate the entire IRA they have inherited.

A designated beneficiary is an **individual** or qualifying trust¹ that is not an eligible designated beneficiary (EDB). An EDB is a:

- Surviving spouse of the IRA owner
- Minor child of the IRA owner
- An individual who is disabled or chronically ill at the death of the IRA owner
- An individual who is older than the deceased IRA owner
- An individual who is less than 10 years younger than the deceased IRA owner

Non-minor EDBs have the potential to use a full life expectancy to stretch out distributions from an inherited IRA instead of the 10-year rule. The specific life expectancy and other rules applicable to all EDBs will be explained in the EDB section later in this paper.

Death of IRA owner on or after RBD

A new requirement of the proposed regulations is that a designated beneficiary must take annual RMDs during the 10-year payout period based on the longer of either the beneficiary's life expectancy or the owner's remaining life expectancy if the owner **died on or after** their RBD.

This new rule creates two possible final liquidation dates for a designated beneficiary who inherits an IRA where the owner died on or after their RBD, either by:

1. December 31 of the 10th year after the owner dies (example 3) or
2. December 31 of the last year of the beneficiary's life expectancy if less than 10 years (example 4)

Example 3 — Death of IRA owner on or after RBD, where beneficiary's life expectancy is longer than 10 years

A traditional IRA owner dies in 2024 leaving behind an IRA to their daughter. The owner is 78 when they die, which is after their RBD. The daughter is 55 in the year the owner dies. She does not meet any of the EDB exceptions. Assuming final regulations are in effect, annual RMD payments are required beginning in 2025.

The daughter has until December 31, 2034, to liquidate the entire inherited IRA because 10 years after the owner's death is shorter than her life expectancy from the Single Life Table (30.6 years) based on the age she will be on December 31 of the year following the year of the owner's death.

The beneficiary will have to take an annual RMD in years 1 through 9 (2025-2033) based on her life expectancy with full liquidation by December 31 in year 10 (2034). The

beneficiary may take more in any year prior to the 10th year up to and including the entire inherited IRA balance.

The first RMD must be taken by December 31 of the year following the year the owner died which is December 31, 2025, in this example. The annual RMD payment is determined by dividing the prior year-end account balance by the appropriate life expectancy factor for the first RMD payment and then subtracting 1 from the previous year life expectancy factor for each subsequent year.

The entire amount distributed to the beneficiary from the inherited IRA will likely be fully taxable as ordinary income but will not be subject to the additional 10% premature distribution tax because of the exception for death of owner.

Please note in this example because the IRA owner died after their RBD there is a year of death RMD for the owner that must be taken. If the IRA owner took the full amount of their RMD for the year of death before they died, then the beneficiary will not have to take any amounts out in the year of death. However, if the IRA owner did not take their entire RMD before their death, then the beneficiary must take any remaining year of death RMD amount using the owner's Uniform Table life expectancy factor based on the age the owner would have been on December 31 of the year of death. The beneficiary is the taxpayer on any year of death RMD they take out. No 10% additional tax will apply to this distribution because the owner has died.

Example 4 – Death of IRA owner on or after RBD, where beneficiary's life expectancy is under 10 years

In the situation where the owner died on or after their RBD it is possible that the life expectancy used to calculate annual payments may be less than 10 years. If so, the final year of the life expectancy term used to calculate annual RMD payments will be the final liquidation point for the inherited IRA, not 10 years after the death of the IRA as in example 3.

For example, an IRA owner, age 96, left an IRA to their brother, age 84. The IRA owner died in 2024 and had taken their full RMD for 2024 before they died. Assuming final regulations are in effect, annual RMD payments are required beginning in 2025.

Because the beneficiary is more than 10 years younger than the IRA owner, the beneficiary is not an EDB. Also, because the IRA owner died after their RBD, the beneficiary must begin taking RMDs by December 31, 2025.

The beneficiary's life expectancy in 2025 from the Single Life Table is 8.1 because they will be 85 at the end of 2025. Since the beneficiary's life expectancy is shorter than 10 years, the RMD received in 2033 will liquidate the entire inherited IRA before the end of the 10th year after the IRA owner's death (2034).

Effect of Revenue Notices 2022-53, 2023-54, & 2024-35 on the annual RMD requirement where IRA owner died on or after RBD

Many beneficiaries of IRA owners who died in 2020 or thereafter and after their RBD have not taken RMDs because there was confusion about any annual payment

requirement under the SECURE Act's 10-year rule. These notices are attempting to clarify this rule.

Notice 2022-53 specifically waived the excise tax on the 2021 and 2022 life expectancy RMD payments that certain designated beneficiaries, but not all, should have taken but did not. Notice 2023-54 waives the excise tax for missed RMDs under this same rule for 2023. Notice 2024-35 waives the excise tax for missed RMDs under this same rule for 2024 and sets the implementation date for this rule in 2025.

These notices do not waive the excise tax for all missed RMDs. Instead, the excise tax is waived for only those designated beneficiaries who, inherited an IRA from an owner who died in 2020 or thereafter, on or after their RBD, and are subject to the 10-year rule. Other RMDs for EDBs, beneficiaries of owners who died prior to 2020, or owner RMDs are still subject to the excise tax if not properly taken.

In example 5, there is a discussion of how the annual payout rule in the proposed regulations could be managed considering these notices.

Please note that this is a hypothetical example and other workflows/outcomes could be followed based on the final regulations or interpretations of the proposed regulations.

Example 5 – Death of IRA owner on or after RBD and in 2020

An IRA owner, age 75, died in 2020, with their son as beneficiary. The son (age 40) is subject to the SECURE Act's 10-year payout provision because he is not an EDB.

The IRA owner died after their RBD, so the son must take RMDs based on his life expectancy in years 1-9 (2021-2029) of the 10-year payout period under the proposed regulations with full liquidation in year 10 (2030). The beneficiary uses their age as of the end of 2021 (41) to establish their initial life expectancy (44.8) from the updated Single Life Table for these annual payments. For every year thereafter 1 is subtracted from the prior year's life expectancy factor.

However, the son did not take his beneficial RMDs in 2021, 2022, 2023, or 2024 because of the various RMD waiver notices mentioned above and is prepared to take his beneficiary RMD in 2025 using the appropriate life expectancy factor (39.8).

Death of IRA owner before RBD

There is no annual distribution requirement (RMD) during the 10-year payout window if the IRA owner died **prior to their RBD**.

Example 6 — Death of IRA owner before RBD

A traditional IRA owner dies in 2021 at age 65. Their adult daughter is named beneficiary of the IRA. She is not an EDB, so the 10-year rule must be used.

The daughter has until December 31, 2031, to liquidate the entire IRA. She does not have to take annual RMDs during the 10-year payout period because the IRA owner died before their RBD.

The daughter may immediately liquidate the entire IRA, wait until December 31, 2031, to liquidate the entire IRA, or she can take partial distributions in any amount during the 10-year period.

10-year rule for Roth IRA beneficiaries

The designated beneficiaries of Roth IRAs do not have to take annual RMDs during the 10-year liquidation period, no matter how old the Roth IRA owner was when they died, because Roth IRA owners do not have an RBD for RMDs.

This means that every designated beneficiary of a Roth IRA will have until December 31 of the 10th year after the Roth IRA owner's death to liquidate the inherited Roth IRA and no annual RMD payments will be required regardless of how old the Roth IRA owner was when they died.

Remaining 10-year payout rule for successor beneficiaries where both IRA owner and original beneficiary died in 2020 or thereafter

When both the IRA owner and the original designated beneficiary died in 2020 or thereafter and the original beneficiary dies within the 10-year period after the death of the IRA owner, the successor beneficiary assumes the original beneficiary's 10-year period, they do not restart their own 10-year period.

The successor beneficiary must also continue taking RMDs if they were being taken by the original beneficiary using the same life expectancy schedule that the original beneficiary was using.

Please note that successor beneficiaries cannot be EDBs.

Example 7 — Death of original beneficiary using 10-year rule when IRA owner died before their RBD

An IRA owner dies in 2022 at age 65 leaving the IRA to their adult daughter, who is not an EDB. The daughter has until December 31, 2032, to liquidate the IRA. The daughter does not have to take annual distributions because the owner died prior to their RBD.

The original beneficiary, the daughter, dies in 2024, and her son (the grandson of the IRA owner) is named as successor beneficiary, and will have until the end of the original beneficiary's 10-year period, December 31, 2032, in this example, to liquidate the entire inherited IRA. The successor beneficiary does not have to take annual distributions because the owner died before their RBD.

At any time while they are alive and prior to the end of the 10th year after the IRA owner's death, the original beneficiary may take distributions from the inherited IRA of any amount up to and including the entire account balance. The successor beneficiary may also take as much as they would like prior to the 10th year once they become owner of the inherited IRA.

Example 8 - Death of original beneficiary using 10-year rule when IRA owner died after their RBD

An IRA owner died in 2024 at age 75 leaving the IRA to their adult daughter, who is not an EDB. The daughter has

until December 31, 2034, to liquidate the IRA. The daughter must take annual distributions based on her life expectancy in years 1 through 9 (2025-2033) because the owner died after their RBD, and her life expectancy is longer. In year 10 (2034) the entire remaining account balance must be liquidated. In any year, the original beneficiary can take more than the RMD including up to the entire account balance.

The daughter uses her life expectancy from the Single Life Table based on the age she will be at the end of the first distribution year, which is December 31, 2025, to calculate the initial RMD.

If the original beneficiary, the daughter, dies in 2026, her son (the grandson of the IRA owner) who is named as the successor beneficiary, and will have until the end of the original beneficiary's 10-year period, December 31, 2034, in this example, to liquidate the entire inherited IRA. The successor beneficiary must continue to take annual RMDs based on the original beneficiary's remaining life expectancy. The successor beneficiary does not use their own life expectancy to calculate these RMDs.

EDB exceptions to the 10-year payout rule - Spouses

The first EDB exception to the 10-year payout rule is for spouses. There are now four options a surviving spouse can use when inheriting an IRA, each of these options will be explored in examples 9 through 13:

- **Spousal re-registration or rollover** - existed pre-SECURE Act
- **Spousal inherited IRA** - existed pre-SECURE Act
- **Surviving spouse may elect the 10-year payout rule if deceased spouse died before their RBD** – clarified by proposed regulations after the SECURE Act
- **Elect to be treated as deceased owner for RMD rules**
 - New rule from SECURE Act 2.0
 - Effective beginning in 2024

Spousal re-registration or rollover

If a surviving spouse re-registers or rolls over an inherited IRA from their deceased spouse into their own name, they will use their Uniform Table life expectancy factor each year to calculate RMDs once they reach their RBD. However, the additional 10% premature distribution tax (10% additional tax) will apply to taxable distributions received prior to age 59½, unless an exception applies.

This option may make sense when the surviving spouse is over age 59½ and younger than or close in age to the deceased spouse. This option was available to surviving spouses prior to the SECURE Act and is still available after the SECURE Act.

The proposed regulations place new distinctions and limitations on the period for spousal re-registrations and rollovers to prevent gaming the 10-year rule in certain spousal inheritance situations which will be explained in the next several paragraphs and in example 12.

Spousal re-registration and rollover time limits

A spousal re-registration must be done by the later of the end of the calendar year in which the surviving spouse reaches RMD age, or the end of the calendar year following the calendar year of the IRA owner's death.

However, this new rule is not as limiting as it seems because even if the spouse fails to re-register the IRA into their own name in a timely manner, they can still do a rollover to their own IRA at any time with one limitation, explained below, if they had initially elected the 10-year payout.

Spousal rollover – No time limits but new netting out RMD rule applies if previously elected 10-year rule

If the spouse initially elected the 10-year rule, they could do a spousal rollover after their RBD of the net amount after they take the RMDs that would have been required after their RBD if the inherited IRA had been rolled over in a timely manner less any actual distributions received by spouse.

This rule will be examined in detail in example 12, in the context of the spouse initially electing the 10-year rule, which is the reason this new rule exists, which is to prevent gaming the 10-year rule to avoid RMDs by surviving spouses.

Example 9 – Simple spousal re-registration or rollover

Assume an IRA owner dies at age 78 in 2022. Their surviving spouse who is 73 is the beneficiary of the IRA. The surviving spouse decides to re-register the IRA into their own name shortly after inheriting the IRA.

Before re-registering the IRA into their own name, the surviving spouse must take any year of death RMD amount that the owner did not take before they died using the owner's Uniform Table life expectancy for a 78-year-old, which is 22. After re-registering the IRA into their own name, the surviving spouse will use their own life expectancy from the Uniform Table to calculate RMDs in subsequent years. In 2023 the life expectancy factor from the Uniform Table the surviving spouse will use for age 74 is 25.5.

Spousal inherited IRA

A surviving spouse who inherited an IRA may elect to leave the IRA in the name of the deceased spouse, often referred to as a spousal inherited IRA, instead of re-registering or rolling over the IRA into their own name. This option was available to surviving spouses prior to the SECURE Act and is still available after the SECURE Act.

In this situation RMDs must begin when the deceased spouse would have reached their RBD, and the Single Life Table life expectancy factor of the surviving spouse is used each year (also known as recalculation method) to calculate RMDs using the spouse's age they would be on December 31 of that particular year. It is important to note that the surviving spouse may re-register or rollover, depending on circumstance (see spousal re-registration time limits section earlier in this paper), the spousal inherited IRA into their own name at any time even if the surviving spouse uses the spousal inherited IRA option for a long period of time.

The spousal inherited IRA may be an option to consider for a surviving spouse that is under age 59½, so they can access the inherited IRA free from the additional 10% premature distribution tax (example 10), or if the surviving spouse is older than the deceased spouse to delay RMDs until the deceased spouse would have reached their RBD (example 11).

Example 10 - Surviving spouse 59½ or younger

Using spousal inherited IRA and spousal re-registration/rollover together

Assume a husband, age 50, with a \$200,000 IRA dies, and his wife, age 49, is named as primary beneficiary. The wife needs to access the money in the IRA for living expenses. What is a tax efficient way for the wife to inherit this IRA?

She could use both the spousal inherited IRA and spousal re-registration/rollover options in succession.

First, the surviving spouse will continue the IRA in the name of the husband for her benefit — a spousal inherited IRA account. This titling allows the surviving spouse to access the funds in the IRA without the 10% additional tax even though she is under 59½, but the distributions are still taxable. No RMDs are required from this account until the husband would have reached his RBD, so the wife is free to take as little or as much as she wishes until that time.

The second step in this income tax efficiency strategy will occur after the wife turns 59½ and re-registers or rolls over the IRA into her own name. This re-registration or rollover will allow the surviving spouse to continue to take distributions from the IRA without the additional 10% tax, since she is now the owner. RMDs do not have to begin until the wife reaches her RBD postponing RMDs longer than if the IRA remained in her husband's name. Finally, the net RMD rule for rollovers after RBD discussed earlier do not apply in this situation because the surviving spouse is undertaking the re-registration or rollover prior to reaching RBD.

Example 11 – Spousal inherited IRA – Older surviving spouse

When the surviving spouse is significantly older than the deceased spouse IRA owner, it may be advantageous to leave it as a spousal inherited IRA to delay RMDs, instead of undertaking a spousal re-registration or rollover.

Delaying RMDs using a spousal inherited IRA can mean more growth potential through a longer period of tax deferral without limiting the surviving spouse's access to the funds for an older surviving spouse.

For example, assume an IRA owner who is 52 dies in 2023 and leaves the IRA to their 68-year-old spouse. If the 68-year-old surviving spouse uses the spousal inherited IRA option, then RMDs will not have to begin until the deceased spouse would have reached their RBD (age 75 in 2046), which in this case is over 20 years away.

If the surviving spouse in this situation re-registers or rolls over the IRA into their own name, RMDs would have to begin when the surviving spouse turns 73 – only 5 years away in 2028.

In this situation the spousal inherited IRA option pushes the RMD start date out further than the re-registration or rollover option.

Surviving spouse may elect the 10-year payout rule if deceased spouse died before their RBD - new rules from the proposed regulations

After the SECURE Act of 2019 and clarified by the subsequent proposed regulations of 2022 a surviving spouse may elect to use the 10-year deferral period if the IRA owned died prior to their RBD.

The option to elect the 10-year deferral rule is **not** available when decedent died after RBD, because the surviving spouse must take annual RMDs based on the longer of either the decedent's life expectancy or surviving spouse's life expectancy.

If the surviving spouse who initially elected the 10-year rule wants to re-register or rollover the inherited IRA to their own name before the end of the 10-year payout period, the proposed regulations provide that a surviving spouse must make the election to re-register into their own name by the later of either:

1. The end of the calendar year in which the surviving spouse reaches RMD age, or
2. The end of the calendar year following the calendar year of the IRA owner's death

But a surviving spouse who initially elected the 10-rule for the IRA they inherited from their deceased spouse can still rollover an IRA into their own name even if they miss the above deadlines for a spousal re-registration if they net out the RMD that would have been taken had a spousal re-registration been done in a timely manner. This netting out of RMDs before rollover rule is in place to prevent manipulation of a surviving spouses' ability to utilize the 10-year payout rule to avoid RMDs as described in example 12 below.

Example 12 – Spousal rollover after electing 10-year rule – New net RMD rule

Applicable when an IRA owner died prior to their RBD, and the surviving spouse initially elects the 10-year option

IRA owner died in 2021 at age 68 (before their RBD) and the surviving spouse turned 65 in 2021. The surviving spouse initially elected to use the 10-year rule, so that the inherited IRA would not have to be liquidated until December 31, 2031, and no annual distributions are required because the owner died before their RBD.

The surviving spouse chose the 10-year rule as their payout option to avoid RMDs until 2031, and then by re-registering or rolling over the IRA into their own name in 2031 they can begin taking RMDs from the IRA using their Uniform Table life expectancy at that time and avoid taking RMDs until they were age 75.

However, the new rules mentioned above will not allow the surviving spouse to undertake this series of actions as they intended, since in 2031 the spouse is over RMD age which is the deadline to re-register the IRA into their own name. However, they can take the RMDs that would have been required to be taken from 73 to 75 had the IRA been re-

registered into their own name in a timely manner, and then rollover the net amount of the inherited IRA to their own IRA.

The total RMD amount that must be taken before the rollover can occur is determined by calculating the RMDs over a series of years beginning when the surviving spouse turned 73 (in 2029) until the current year (2031) in our example, net of any distributions taken during that time. For this example, we are assuming that no distributions were taken from the inherited IRA during this time.

3 years of RMDs (2029-2031) are distributed from the 2031 account value, and then the net amount can be rolled over to the surviving spouse's own IRA. The 3 years of RMDs are taxable income to the surviving spouse in the year received.

Elect to be treated as deceased owner – new rule from SECURE Act 2.0

Section 327 of SECURE Act 2.0 allows a surviving spouse to elect to be treated as the deceased spouse for purposes of the RMD rules. It is effective beginning in 2024. A note of caution to consider with this new option is that it may take time for plans and IRA providers to adopt.

The benefits of this option versus other spousal inheritance options are:

- Allows a surviving spouse to delay taking RMDs until the deceased spouse would have reached RMD age because the IRA remains in the name of the deceased spouse for the benefit of the surviving spouse
- Permits smaller RMDs because the age equivalent life expectancy factors for the Uniform Table are larger than the life expectancy factors from the Single Life Table
- If the deceased spouse died before their RBD the surviving spouse's beneficiaries will be treated as though they were the **original** beneficiaries of the IRA, so if they are designated beneficiaries, they can use the 10-year delay rule from the surviving spouses' death year not the original owner's death year and if the beneficiaries are EDBs they can stretch over life expectancy.

Please Note: The surviving spouse must make an affirmative election to use this rule and once made this election to be treated as the deceased spouse cannot be revoked.

This option may be preferable for a surviving spouse who is older than the deceased spouse as compared to either the spousal re-registration/rollover option or the spousal inherited IRA option because:

- RMDs can be avoided for longer because the RMD beginning age is based on the younger deceased spouse's age
- Smaller RMDs would result from using the Uniform Table to calculate RMDs instead of using the Single Life table

Under SECURE Act 2.0, this option is available when the IRA owner dies before their RBD. It is important to note that

the Treasury Department will have to issue new regulations for this option to apply for death of the IRA owner on or after the RBD.

Example 13 – Surviving spouse elects to be treated as deceased owner

IRA owner unfortunately dies of an illness on January 2, 2024. In 2024, IRA owner will be 52 and their spouse will be 68. The surviving spouse elects to be treated as the deceased owner.

This new spousal inheritance option compares favorably to the spousal re-registration option because RMDs can be delayed an additional 18 years until the deceased spouse would have reached their RMD age of 75 in 2047 versus having to start RMDs when the older surviving spouse reaches their RMD age of 73 in 2029 if re-registered into the surviving spouses own name.

It also compares favorably to the spousal inherited IRA option because a smaller RMD amount can be taken out since the larger life expectancies of the Uniform Table are being used to calculate the RMDs instead of the shorter life expectancies of the Single Life Table.

In this example, the difference in life expectancy factor length for the first RMD under this option for 2047 at age 91 results in \$10,172.27 less having to be taken out versus the spousal inherited option (assuming a \$100,000 prior year 12/31 IRA value) because the surviving spouses' life expectancy factor from the Uniform Table for age 91 (age they will be in 2047) is 11.5 versus the age 91 life expectancy of 5.3 from Single Life Table.

- RMD using Uniform Table life expectancy of 11.5 is \$8,695.66 (\$100k/11.5)
- RMD using Single Life Table life expectancy of 5.3 is \$18,867.93 (\$100k/5.3)
- RMD differential (\$18,867.93 - \$8,695.66 = **\$10,172.27**)

Ultimately, electing the new option to be treated as the deceased spouse allows an older surviving spouse to delay RMDs (18 years of additional tax deferral in this example) and smaller RMDs (\$10,172.27 in our example) than other spousal inheritance options.

EDB exceptions - Minor child of the IRA owner

A **minor child beneficiary of the IRA owner** may use their life expectancy to calculate RMDs from the inherited IRA instead of using the 10-year rule because they are considered an EDB. The proposed regulations define a minor for purposes of this rule as **under 21 years of age**.

The first life expectancy-based payment must be taken by the EDB minor's custodian by December 31 of the year following the year the owner dies, and then every year thereafter until the **earlier** of either 10 years after the EDB minor's death or December 31 of the year they turn age 31.

The EDB minor's initial life expectancy is determined from the Single Life Table based on the age they will be on December 31 of the year following the year the owner died. In subsequent years 1 is subtracted from the prior year life expectancy to calculate the annual RMD. An annual RMD

must be taken every year using the EDB's remaining life expectancy, including after the EDB turns age 21 or dies, until reaching the final liquidation year.

It is important to note that this rule **applies only to minors who inherit an IRA from their parent**; it does not apply to other minors who inherit an IRA from a nonparent, for instance from grandparents or other family members. In those situations, the minor would use the 10-year rule as they are considered only a designated beneficiary, not an EDB.

Example 14 — Minor as beneficiary lives to age 31

An IRA owner dies in 2021 leaving the IRA to their 12-year-old daughter. Because the daughter is under age 21 at the time of the owner's death, she is considered a minor and can use her life expectancy to take out RMDs from the inherited IRA as an EDB. The life expectancy-based payments must begin by December 31, 2022.

Further assume that the EDB lives until age 31, which is the final liquidation point for the inherited IRA – the end of the 10th year after the EDB minor reaches age 21, which in this example is December 31, 2040. Thus, under this EDB exception a minimum life expectancy-based payment must be taken every year from 2022 to 2039 with full liquidation of the inherited IRA in 2040.

Example 15 – Minor as beneficiary who dies while still a minor

The facts are the same as in example 14 except the minor EDB in this example dies in 2024, at age 16, while they are still taking life expectancy-based payments. In this situation the successor beneficiary would have until December 31, 2034, to liquidate the inherited IRA – 10 years from the original minor EDB's year of death as a minor. The successor beneficiary must also continue to take annual RMDs every year using the remaining life expectancy of the original minor EDB until full liquidation of the inherited IRA in 2034.

Example 16 – Minor as beneficiary who dies after reaching age 21

The facts are the same as in example 14 except the original minor EDB dies in 2032 after they have reached age 21 (in 2030). We will also assume the original EDB took their 2032 annual life expectancy payment before they died. In this situation the successor beneficiary would have until the end of the 10-year period established when the minor EDB reached age 21 to liquidate the inherited IRA.

The original minor EDB reached age 21 in 2030, so the successor beneficiary must liquidate the entire inherited IRA by December 31, 2040. The successor beneficiary must also continue to take annual distributions every year (from 2033 to 2039) using the remaining life expectancy of the original minor EDB until full liquidation of the inherited IRA in 2040.

EDB Exceptions - Disability

If the IRA owner died prior to their RBD a disabled beneficiary of an IRA owner has the option to take inherited IRA distributions over their life expectancy, instead of the 10-year rule because they are an EDB.

The disabled beneficiary's status is determined as of the date of the participant's death.

When the disabled beneficiary dies in this situation the inherited IRA must be liquidated at the **earliest of either** the end of the 10th year after the disabled beneficiary's death or the final year of the remaining life expectancy of the disabled original beneficiary. The successor beneficiary must continue to take annual distributions until the entire inherited IRA is liquidated.

If the IRA owner died on or after their RBD a disabled beneficiary has the option to take inherited IRA distributions **over the longer** of their life expectancy or the owner's remaining life expectancy, instead of the 10-year rule.

When the disabled beneficiary dies in this situation the inherited IRA must be liquidated at the **earliest of either** the end of the 10th year after the disabled beneficiary's death, the final year of the remaining life expectancy of the disabled original beneficiary, or the final year of owner's remaining life expectancy. The successor beneficiary must continue to take annual distributions until the entire inherited IRA is liquidated.

An individual is considered disabled if they meet the definition of disability provided in Internal Revenue Code (I.R.C) Section 72(m)(7).² The proposed regulations provide an additional definition of disability if the beneficiary is under age 18.³

The proposed regulations also state that if someone is found to be disabled by the Social Security Administration than they are automatically considered an EDB.

Life expectancy-based payments must begin by December 31 of the year following the year of the IRA owner's death.

EDB Exceptions - Chronic illness

If the IRA owner died prior to their RBD a chronically ill beneficiary of an IRA owner has the option to take inherited IRA distributions over their life expectancy, instead of the 10-year rule because they are an EDB.

The chronically ill beneficiary's status is determined as of the date of the participant's death.

When the chronically ill beneficiary dies in this situation the inherited IRA must be liquidated at the **earliest of either** the end of the 10th year after the chronically ill beneficiary's death or the final year of the remaining life expectancy of the chronically ill original beneficiary. The successor beneficiary must continue to take annual distributions until the entire inherited IRA is liquidated.

If the IRA owner died on or after their RBD a chronically ill beneficiary has the option to take inherited IRA distributions **over the longer** of their life expectancy or the owner's remaining life expectancy, instead of the 10-year rule.

When the chronically ill beneficiary dies in this situation the inherited IRA must be liquidated at the **earliest of either** the end of the 10th year after the chronically ill beneficiary's death, the final year of the remaining life expectancy of the chronically ill original beneficiary, or the final year of owner's remaining life expectancy. The successor

beneficiary must continue to take annual distributions until the entire inherited IRA is liquidated.

The definition of chronically ill is provided by I.R.C. Sec. 7702B(c)(2) and the beneficiary's status is determined as of the date of the participant's death.⁴

Life expectancy-based payments must begin by December 31 of the year following the year of the IRA owner's death.

EDB Exceptions - Beneficiary older than IRA owner, owner death on or after RBD

When an IRA owner dies on or after their RBD an individual that is older than the IRA owner may use the **owner's remaining life expectancy, because it is longer than the beneficiary's,** to calculate RMDs from the inherited IRA instead of using the 10-year rule because they are an EDB.

If the original EDB beneficiary dies before the end of the owner's life expectancy and the owner died on or after their RBD, the successor beneficiary must liquidate the entire inherited IRA at the **earlier** of the 10th year after the EDB dies, the end of the owner's remaining life expectancy, or the end of the EDB's life expectancy. The successor beneficiary must continue to take annual payments based on the owner's remaining life expectancy each year until full liquidation.

Example 17 – Beneficiary older than IRA owner, IRA owner death on or after RBD

An IRA owner, age 73, died in 2022, before his birthday. The deceased owner's older sister is the original beneficiary, and she is 82.

The original beneficiary is an EDB because she is older than the deceased owner which means life expectancy can be used as the payout option instead of the 10-year rule. The deceased brother's remaining life expectancy can be used because it is longer than the EDB's and the owner died after his RBD.

The deceased owner's initial life expectancy is determined from the Single Life Table based on the age he would have been on December 31 **of the year he died**. The deceased owner's age on December 31, 2022, is 74 so the life expectancy factor from the Single Life Table for a 74-year-old is 15.6 years.

The EDB must take the first life expectancy-based payment by December 31, 2023. The deceased owner's life expectancy in 2023 will be 14.6 (15.6 - 1 = 14.6), and for every year thereafter 1 is subtracted from the prior year life expectancy to establish the life expectancy that will be used in the RMD calculation for that year. This makes 2037 the final year of the deceased owner's life expectancy schedule.

For comparison purposes if the EDB's life expectancy was being used to calculate RMDs her initial life expectancy would be 9.3 which is the Single Life Table life expectancy factor for an 83-year-old. This makes the final year of the EDB's life expectancy schedule 2032.

The EDB names her daughter as her successor beneficiary. The EDB dies in 2024.

The successor beneficiary must liquidate the inherited IRA by 2032 because that is the **earliest** of the three possible end points required by the proposed regulations, which are either the:

- End of the 10th year after the original beneficiary's death, in this example that is December 31, 2034; or,
- Last year of EDB's life expectancy, in this example that is 2032; or,
- Last year of owner's life expectancy, in this example that is 2037

The daughter as successor beneficiary must also continue to take annual RMDs based on the deceased owner's life expectancy until full liquidation in 2032.

EDB Exceptions - Beneficiary older than IRA owner, owner death before RBD

When an IRA owner dies before their RBD an individual beneficiary that is older than the IRA owner may use their own life expectancy to calculate RMDs from the inherited IRA instead of using the 10-year rule because they are considered an EDB. The longer life expectancy of the deceased IRA owner, described in example 17, is not an option in this situation because the owner died before their RBD. The longer life expectancy of the deceased owner is only available to use when the IRA owner dies on or after RBD.

If the original EDB beneficiary dies before the end of their life expectancy and the owner died before their RBD the successor beneficiary must liquidate the entire inherited IRA at the earlier of the 10th year after the EDB dies or the end of the EDB's life expectancy. The successor beneficiary must continue to take RMD payments each year using the remaining life expectancy of the older EDB until the entire inherited IRA is liquidated.

Example 18 - Beneficiary older than IRA owner, owner death before RBD

An IRA owner died in 2022 at age 68. The original beneficiary is the IRA owner's sister who is 75. The original beneficiary can use their life expectancy (14.1) to stretch out payments from the inherited IRA instead of using the 10-year rule because they are an EDB since they are older than the deceased IRA owner. The deceased IRA owner's life expectancy is not used in this example even though it is longer because the IRA owner died before their RBD.

The EDB's life expectancy is determined based on the age they will be on December 31, 2023. The first life expectancy-based payment must be withdrawn by December 31, 2023.

Life expectancy-based payouts in this situation allow for a longer period of tax deferral which may have more wealth building potential than the 10-year rule. Under the 10-year rule, full liquidation would have to occur by December 31, 2032, but with life expectancy-based payments the final liquidation date is December 31, 2037, since the original beneficiary is an EDB, and their life expectancy (14.1) is longer than 10 years.

Further assume the EDB named her daughter as successor beneficiary.

If the EDB dies in 2030, her remaining life expectancy is 7.1 years at this point.

The successor beneficiary has until the shorter of the 10th year after the original EDB dies (2040) or the end of the EDB's life expectancy (2037) to liquidate the inherited IRA.

Because the EDB's remaining life expectancy (7.1) ends sooner (2037) than 10 years (2040) from her year of death (2030) the successor beneficiary has until December 31, 2037, to liquidate the entire inherited IRA.

Finally, because the EDB was taking annual life-expectancy based payments the successor beneficiary must continue to take annual distributions as well based on the EDB's remaining life expectancy.

EDB Exceptions – Less than 10 years younger than owner

An individual who is less than 10 years younger than the IRA owner may use their own life expectancy, regardless of when the owner died, to calculate RMDs from the inherited IRA, instead of using the 10-year rule, because they are considered an EDB.

Distributions must begin by December 31 of the year following the year of the owner's death. The EDB's age on December 31 of the year following the year of the owner's death is used to determine the initial life expectancy factor from the Single Life Table.

If the EDB dies before the end of their life expectancy and the IRA owner died before their RBD, the successor beneficiary must liquidate the entire inherited IRA at the **earlier** of the end of the 10th year after the EDB's death or the end of the EDB's remaining life expectancy, see example 19.

If the EDB dies before the end of their life expectancy and the IRA owner died on or after their RBD, the successor beneficiary must liquidate the entire inherited IRA at the **earlier** of the end of the 10th year after the EDB's death, the end of the EDB's remaining life expectancy or the end of the owner's remaining life expectancy, see example 20.

Example 19 — Less than 10 years younger beneficiary, owner died before RBD, EDB dies with more than 10 years of life expectancy remaining

An IRA owner dies in 2022, at age 58, leaving the account to their unmarried partner, age 55. The original beneficiary can use their life expectancy to take annual RMDs from the inherited IRA because they are less than 10 years younger than the deceased owner.

The life expectancy-based payments must begin by December 31, 2023. The original beneficiary's initial life expectancy (30.6) is established based on the age (56) they will be at the end of the first distribution year – December 31, 2023.

The EDB's son is named successor beneficiary.

Further assume that the original beneficiary dies in 2029.

This means the successor beneficiary has until the end of the 10th year after the original beneficiary dies – December 31, 2039 – to liquidate the inherited IRA because 10 years is less than the original beneficiary's remaining life expectancy (24.6).

The successor beneficiary will have to continue to take annual distributions based on the original beneficiary's remaining life expectancy every year until full liquidation in 2039.

Example 20 – Less than 10 years younger beneficiary, owner died after RBD, EDB dies with less than 10 years of life expectancy remaining

An IRA owner died in 2022, at age 76, leaving the account to their cousin, age 67. The original beneficiary is an EDB because they are 9 years younger than the owner, which means life expectancy can be used as the payout method instead of the 10-year rule.

The EDB's life expectancy is used to calculate the annual RMDs because the EDB's life expectancy (20.4) is longer than the deceased owner's remaining life expectancy (14.1) as of the appropriate age establishment date for each.

The EDB's daughter is named successor beneficiary.

Further assume that the EDB dies in 2035. This means that the successor beneficiary must liquidate the entire inherited IRA at the earlier of either:

- The 10th year after the EDB's death – December 31, 2045, or,
- The end of the EDB's remaining life expectancy (8.4) – December 31, 2043, or
- The end of the deceased owner's life expectancy (2.1) – December 31, 2037.

Thus, because the deceased owner's remaining life expectancy is the earliest of these 3 dates the successor beneficiary must liquidate the inherited IRA by the end of 2037 and take a life expectancy-based payment in 2036 based on the EDB's remaining life expectancy factor for that year of 7.4.

ADDITIONAL IRA PAYOUT RULES AFTER THE SECURE ACT

Annuitized IRAs

The 10-year payout rule also applies to IRAs annuitized after December 31, 2019. As a result, a nonspouse designated beneficiary of an annuitized IRA would have no more than 10 years to receive any death proceeds as continuing payments or as a lump sum commutation value (if available), unless they are an EDB.

Example 21 — Death of an annuitized IRA annuity owner, annuitized after 2020

An individual annuitized an IRA in 2020 with a life and 20-year term certain payout option. Further assume the owner died in 2022 and the owner's nephew is named as beneficiary. The nephew must take all remaining payments by December 31, 2032, instead of over 18 years that is

remaining of the term, unless the nephew is an EDB. The beneficiary could take a commutation value in 2022, if available, or take regular payments each year from 2023-2031 and then in 2032 take the commutation value of the remaining 8 years of payments.

Designated beneficiary trust as IRA beneficiary

After December 31, 2019, if a trust is considered a designated beneficiary the trust will have at most 10 years following the owner's death to liquidate the entire IRA, unless an exception applies permitting life expectancy-based payments for certain trust beneficiaries that qualify as an EDB under certain circumstances.

For a more detailed explanation of trusts as beneficiaries of IRAs, see our white paper "Trust as Beneficiary of an IRA" NFM-22340AO.

Estates, charities, and non-designated beneficiary trusts as IRA beneficiaries

When an estate, non-designated beneficiary trust, or charity is the beneficiary of an IRA those entities will use one of the following rules:

- If the IRA owner died prior to their RBD then the entity will have until December 31 of the **5th** year following the year of the owner's death to liquidate the entire IRA, or,
- If the IRA owner died on or after their RBD then the owner's remaining life expectancy may be used to liquidate the IRA

IRA BENEFICIAL PAYOUT RULES FOR IRA OWNER DEATHS PRIOR TO 2020

Life expectancy payouts may continue

If an IRA owner died prior to 2020, then the original designated beneficiary can continue using the life expectancy method or any other payout rule they were using prior to the passage of the SECURE Act.

Example 22 — Death of IRA owner in 2018

An IRA owner died in 2018 and left the IRA annuity to their son. The son may use his life expectancy to stretch out the inherited IRA because the IRA owner died prior to the effective date of the SECURE Act (January 1, 2020). The son had until December 31, 2019, to take out his first life expectancy-based payment. Every year thereafter the son must take out the minimum life expectancy-based amount, but he can always take more.

Original beneficiary dies in 2020 or thereafter

If the owner died prior to 2020 and the original beneficiary dies in 2020 or thereafter, the successor beneficiary has until December 31 of the 10th year following the original beneficiary's death to liquidate the inherited IRA. The

successor beneficiary will have to continue to take annual distributions based on the original beneficiary's remaining life expectancy every year with full liquidation by December 31 of 10th year following the original beneficiary death.

Please note that a successor beneficiary cannot be an EDB.

Example 23 — Death of original beneficiary after 2020

The facts are the same as in example 22, but the original beneficiary dies in 2023. Further assume that the original beneficiary's nephew is named as successor beneficiary.

In this situation the nephew, as successor beneficiary, would have until the end of the 10th year from the year of the original beneficiary's death, December 31, 2033, to liquidate the entire amount remaining in the inherited IRA.

Even though the IRA owner died prior to the SECURE Act, the original beneficiary's death occurred after 2019 so the 10-year rule applies to the successor beneficiary. The successor beneficiary would also have to continue taking annual distributions based on the original beneficiary's remaining life expectancy from 2024 until 2032. With full liquidation occurring in 2033.

Pre-2020 IRA annuitization

A beneficiary who inherits an IRA that was annuitized prior to January 1, 2020, will not be required to use the 10-year payout rule; instead, they will be able to continue to use the selected payout option.

Example 24 — Death of an annuitized IRA owner, annuitized prior to 2020

An individual annuitized an IRA in 2018 with a life and 20-year term certain payout option. Then in 2022 the owner dies, and the owner's niece is named as beneficiary. The niece may either continue to receive payments for the remaining 16 years of the term certain or take a lump sum commutation value of the remaining payments (if the contract allows) because the IRA annuitization payout was started prior to 2020.

CONCLUSION

The SECURE Act, resulting IRS proposed regulations, and SECURE Act 2.0 have brought notable change to the beneficiary payout options of IRAs and other qualified accounts, but do not affect nonqualified deferred annuities.

Advisors should be aware of these changes and be ready to discuss and implement the new rules to help their clients meet their wealth transfer goals. For the individual beneficiaries of nonqualified annuities, the potential wealth transfer effectiveness of life expectancy-based payments is still a tool that they can use to meet their inheritance planning goals.



This material is not a recommendation to buy or sell a financial product or to adopt an investment strategy. Investors should discuss their specific situation with their financial professional.

Federal income tax laws are complex and subject to change. The information in this memorandum is based on current interpretations of the law and is not guaranteed. Neither Nationwide, nor its employees, its agents, brokers, or registered representatives give legal or tax advice.

Nationwide, the Nationwide N and Eagle and Nationwide is on your side are service marks of Nationwide Mutual Insurance Company. © 2024 Nationwide

NFM-19170AO.6 (05/24)

¹ To be considered a designated beneficiary, a trust must meet the following requirements:

- The trust beneficiaries must be individuals clearly identifiable (from the trust document) as designated beneficiaries as of September 30 following the year of your death.
- The trust must be valid under state law; a trust that would be valid under state law, except for the fact that the trust lacks a trust "corpus" or principal, will qualify.
- The trust must be irrevocable, or (by its terms) become irrevocable upon the death of the IRA owner or plan participant.
- The trust document, all amendments, and the list of trust beneficiaries (including contingent and remainder beneficiaries) must be provided to the IRA custodian or plan administrator by the October 31 following the year of your death. Treas. Reg. §1.401(a)(9)-4, Q&A-5(b)(2)

² The definition of disabled as provided in I.R.C. Sec. 72(m)(7) is "if he/she is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long continued and indefinite duration."

³ The beneficiary must have a physical or mental impairment "that results in marked and severe functional limitations" and can be expected to result in death or to last indefinitely. Prop. Reg. § 1.401(a)(9)-4(e)(4)(iii)

⁴ An individual will be considered "chronically ill" under Sec. 7702B(c)(2) if he/she is unable to perform at least two of six activities of daily living (ADL) without assistance for ninety days or if he/she requires substantial supervision to ensure such individual's safety from threats to their health and safety due to severe cognitive impairment. The six ADLs are eating, toileting, transferring, bathing, dressing, and continence. Toileting is the ability get to and from the toilet and related personal hygiene actions. Transferring is the ability to walk or move from bed or chair and back again. Continence is the ability to control one's bowels or bladder.