Changes to the 10-year rule could surprise retirement account heirs

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The SECURE Act (Setting Every Community Up for Retirement Enhancement Act of 2019) took effect beginning in 2020, ushering in significant changes to retirement accounts.

New rules govern how retirement account distributions are treated following the death of the owner.

The Treasury Department on February 24, 2022, published a ***Notice of proposed rulemaking and notice of public hearing*** (PDF) addressing required minimum distributions (RMDs), including clarity on aspects of the SECURE Act.

Among the proposals is a provision that makes additional changes to the requirements of the 10-year rule for heirs.

Since these proposed rules are subject to a 90-day comment period followed by public hearings, there could be modifications as the process evolves.

The 10-year rule may require annual distributions

Eligible designated beneficiaries

- Surviving spouses
- Individuals with disabilities
- Those who are chronically ill
- Minor child of account owner
- Beneficiary not more than 10 years younger than the deceased account owner

- The biggest surprise from the proposed regulations is clarification on how the new 10-year rule applies in certain cases
- Under SECURE, the 10-year rule generally states that certain beneficiaries must fully distribute the retirement account over a 10-year period following the year of the death of the owner. This provision effectively eliminated the “stretch” provision for most beneficiaries
- The SECURE Act defined five types of Eligible Designated Beneficiaries (EDBs), including surviving spouses for example, who are still able to stretch required distributions based on their remaining life expectancy
- For heirs subject to the 10-year rule, initial interpretation of the legislation held that no annual distributions were required. The only requirement was the account had to be fully liquidated by the end of the 10th year following the year of death of the owner
- However, the latest proposals state that if the account owner died after their required beginning date (RBD),* then the beneficiary would have to take annual distributions based on their life expectancy for the first 9 years, followed by full distribution of the account in the 10th year
- If the account owner died prior to RBD, then the 10-year rule — without annual distribution requirement — will apply

*Required beginning date (RBD) is generally April 1 of the year following the calendar year in which the account owner reaches age 72.

Distribution rules differ

The distribution rules differ depending on whether the account owner died before their required beginning date.

Owner death before RBD (required beginning date)	Distribution rule
YES	Beneficiary must distribute the account within 10 years following year of death of the owner, no annual distributions are required
NO	Beneficiary must take annual distributions (based on life expectancy) for the first 9 years followed by full distribution in year 10

Additional highlights

- If a beneficiary taking distributions based on the 10-year rule dies before the account is exhausted, the successor beneficiary must take distributions based on the remaining 10-year period of the original beneficiary (for example, death of the original beneficiary would not trigger a new 10-year period for the successor beneficiary)
- Under SECURE, beneficiaries of the original account owner who are minors are considered eligible designated beneficiaries (EDBs) and are allowed to stretch required distributions based on their life expectancy until reaching the “age of majority.” After that, the 10-year rule applies to distributions. Under the proposed regulations, the age of majority is defined as 21, regardless of applicable state law
- Under SECURE, beneficiaries who are not more than 10 years younger than the account owner are considered EDBs. The proposed regulations use the actual date of birth, not just the year of birth, to determine if the beneficiary is not more than 10 years younger than the decedent. For example, if an account owner’s date of birth is October

1, 1953, then the beneficiary is not considered more than 10 years younger if they were born on or before October 1, 1963

- Proposed regulations also allow an EDB to use the 10-year rule as an alternative to life expectancy distributions if desired

Do certain heirs need to take distributions this year?

The big twist in the proposals is the requirement that certain beneficiaries subject to the 10-year rule take annual distributions for the first 9 years, followed by a lump-sum distribution by the end of the 10th year. Consider a beneficiary who inherited a retirement account in 2020, where the account owner died after their RBD, and has not taken any distributions from the account. Does that individual have to take a distribution for this year (and maybe another distribution for 2021) to satisfy the new interpretation of the 10-year rule under the new regulations? Since these are proposed regulations subject to change, these beneficiaries should be able to wait and see how the process plays out. If the requirement for annual distributions under the 10-year rule is confirmed, then there should be guidance on how to proceed.

For more information on the SECURE Act and its current impact on retirement planning, read, **"Understanding the SECURE Act and its implications on planning."** (PDF)

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