Inherited IRAs in 2025 and Beyond: A CPA's Overview

Now that the IRS has finalized the SECURE Act Regulations proposed in December 2019, CPAs should know the basics of the new rules pertaining to inherited IRAS and the "stretch" provision. Let's look at what's changed and what you need to know.

The Old Stretch Inherited IRA

Before the SECURE Act, non-spouse inherited IRA beneficiaries (those who inherited from someone other than their spouse) could take required minimum distributions (RMDs) over their own lifetime (otherwise known as "stretching" these distributions out over a long period). This allowed the funds in the inherited IRA to continue to grow while deferring taxes for decades.

The New "10-Year Rule" for Inherited IRAs

The finalized SECURE Act replaced this long-term stretch provision with a 10-year limit. Now, most non-spouse beneficiaries must fully distribute the funds held by the inherited IRA ***within 10 years of the account owner's death.*** This means that non-spouse beneficiaries today may wind up with a smaller inheritance in their pockets and larger taxable events as they withdraw the funds. However, there are exceptions and differing implications for Roth and non-Roth IRA accounts.

Exceptions to the 10-Year Rule for Inherited IRAs

With some exceptions, inherited IRA beneficiaries who qualify as "eligible designated beneficiaries," (EDBs) can still "stretch" distributions across their own life expectancy, just like under the old rules before the SECURE Act. These exceptions may apply to:

- Surviving spouses
- Minor children of the decedent until they reach the age of 21
- Disabled or chronically ill individuals
- Beneficiaries who are **not more** than ten years younger than the IRA owner

A Surprising Twist – Required Minimum Distributions (RMDs) and the 10-Year Rule

Per finalized IRS regulations in 2024, non-eligible designated beneficiaries (non-EDBs) of IRAs inherited from account owners who were already required to take RMDs **must continue** to take RMDs during the 10-year withdrawal period,

When the IRS first published this rule in its 2022 Proposed Regulations, it caught many by surprise, as the SECURE Act wording had initially led some to interpret that all non-EDBs would be allowed to deplete the inherited IRA account within 10 years, without annual withdrawal requirements.

Due to this confusion, the IRS issued a series of Notices providing for a waiver of penalties for RMDs not taken in 2021-2024 from inherited accounts. The finalization of the regulations in 2024 has now resolved this lingering uncertainty.

Tax Planning for Inherited IRAs

IRA distributions from non-Roth accounts are taxable as income to beneficiaries and therefore may push them into a higher tax bracket, depending on their tax situation. For those impacted, taking higher distribution amounts in years of lower income, before the end of the 10-year rule timeline, may be beneficial.

Tax bracket planning may also help beneficiaries monitor inherited IRA distribution taxes. This planning involves knowing the tax rate relevant to the client's income level and using that information to make strategic decisions. Tax bracket planning can encompass various tactics, such as income splitting among family members, deferring income, or shifting income through multiple periods.

The inherited IRA 10-year rule also applies to Roth IRAs. However, since Roth IRA distributions are tax-free, they will not impact the beneficiaries' taxable income in the years the disbursements occur.

Other IRA Transfer Strategies

Despite the stretch IRA provision changes, other tax-efficient strategies can still be utilized to transfer assets to heirs.

- Roth IRA Conversion: This strategy involves the account holder moving funds from a traditional IRA to a Roth IRA and paying taxes upfront so that future withdrawals can be tax-free.
- Cash Value Life Insurance: Cash Value or whole life insurance policy premiums can be paid with IRA distributions. The proceeds from these policies are typically tax-free and not subject to the ten-year rule.
- Qualified Charitable Distributions (QCDs): May help an inherited IRA beneficiary avoid additional taxable income from an RMD by distributing some or all the RMD to charity instead, subject to the normal QCD eligibility rules.

It's vital that clients understand the SECURE Act's implications for inherited IRAs. Today, if they fail to take required distributions during the ten-year period, they may face a 25% IRS penalty on the amount they ***should have*** withdrawn. If the missed distributions are corrected promptly, the penalty may be reduced to 10%, and of course, taxpayers can request that the IRS forego the penalty entirely on a reasonable cause basis.

With these changes regarding the stretch provision for 2025, timely and proactive estate and tax planning considerations have become even more essential. The 10-year rule makes it imperative for clients to engage with their team of tax, financial, and estate planning professionals specializing in wealth transfer strategies.

Contact Us

If you want to learn more about how SECURE ACT could impact your clients, please feel free to contact us or reach out to a Choreo advisor directly. If we can be of any additional service or if you'd like more information about how Choreo advisors partner with tax professionals don't hesitate to reach out. www.choreoadvisors.com/contact-us

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