EDBS HAVE A CHOICE: STRETCH VS. 10-YEAR

Monday, February 20, 2023

By Andy Ives, CFP®, AIF®
IRA Analyst
Follow Us on Twitter: @theslottreport

By now, most are aware the SECURE Act created a new class of beneficiaries called "eligible designated beneficiaries" (EDBs). This group includes surviving spouses, minor children of the account owner (until age 21), disabled individuals, chronically ill individuals, and people who are not more than 10 years younger than the IRA owner. (Those older than the IRA owner also qualify.)

EDBs have a distinct advantage over non-EDBs: they are allowed to stretch required minimum distributions (RMDs) from an inherited IRA. While non-EDBs are saddled with the newly created 10-year rule (which dictates the entire inherited IRA must be depleted by the end of the tenth year after the year of death), EDBs can blissfully continue to elongate the distribution period over their own single life expectancy. In many cases this can be decades. For years and years an EDB can minimize taxes by only taking the RMD. For years and years an EDB can leave the bulk of inherited Roth IRA dollars in the account, allowing them to grow tax free.

But what if an EDB wanted the 10-year rule? In fact, if the IRA owner died before the required beginning date (RBD) - when lifetime RMDs officially begin - an EDB can choose if they want the 10-year rule to apply or if they want the full stretch. But be aware: there is no flip-flopping back and forth. Once a decision is made, it is final. (There is a rare exception in a specific situation that allows an EDB to switch from the stretch to the 10-year when an RMD is missed, but that corrective change is not the focus of this article.)

Additionally, an EDB who inherits more than one IRA could choose to stretch one of the accounts and apply the 10-year rule to the other. There is no law dictating that all inherited IRAs must follow the same payout structure. So, when would the 10-year make sense to an EDB?

Example: Robert is 68. He has a traditional IRA and a Roth IRA. Robert names his younger sister Rita, age 65, as his primary beneficiary on both accounts. Rita qualifies as an EDB because she is not more than 10 years younger than Robert. Sadly, Robert dies.

Since Robert died before his RBD on his traditional IRA, there will be no RMDs in years 1 – 9 for a beneficiary subject to the 10-year rule. (If Robert died on or after his RBD, there would be RMDs in years 1 – 9 of the 10-year period.) As for his Roth IRA, all Roth IRA owners are deemed to die before the RBD, no matter how old they are, because Roth IRAs have no **lifetime** RMDs.

Rita establishes two inherited accounts. She wants to minimize taxes, so she elects to stretch RMD payments on the inherited **traditional** IRA. If Rita simply takes the annual RMD, not only should the account last for over 20 years (based on her age), but this extended payout period will also soften the tax hit, smoothing it out over two decades.

Rita elects the 10-year rule on the inherited **Roth** IRA. Since Roth IRA owners are deemed to have died before the RBD, Rita will have no RMDs in years 1 – 9 of the 10-year period, but she will have to empty the account at the end of year ten. Nevertheless, the entire inherited Roth IRA can remain untouched for a decade. When it is finally paid out, Rita will enjoy a tax-free windfall.