

A Big RMD Mistake

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Take-Away: IRA custodian need to be attentive and knowledgeable when helping to open IRA accounts and when determining when required minimum distributions are mandated. It also helps to have the IRA owner, or the beneficiary of the inherited IRA sitting across the table from the custodian.

Background: The SECURE Act 2.0 changed the penalties for the failure to take a required minimum distribution (RMD.) Prior to 2023 there was a 50% penalty on any RMD shortfall. Under the Act, that penalty was reduced from 50% to 25%, and down further to 10% if the failure to take the correct amount of RMD is timely corrected. In the past the IRS consistently waived the penalty if the IRA owner took the missed RMD and filed Form 5329 with a statement showing reasonable cause. It is still unclear if the IRS will continue this ‘forgiving’ policy with the reduced penalties, but early indications are that it will continue to grant waivers of the penalty.

Statute of Limitations: The SECURE Act 2.0 also imposes a three-year statute of limitations for the IRS to enforce missed RMDs and impose penalties. This limitations period starts with the tax-filing deadline, *not including extensions, for the year the RMD is missed*. Prior to the Act’s change the limitations period did not start to run until a Form 5329 was filed, so the IRS could conceivably go back many years to assess the RMD penalty. [Recall that all penalties were waived for 2020 with the CARES Act.]

IRA Custodian Reporting: IRA custodians must report on Form 5498 for a year, which is provided to the IRA owner and to the IRS, whether the IRA owner must take an RMD for the year in which the Form is provided. The custodian usually does not report the amount of the RMD on this Form. If the RMD is not reported on the Form 5498, the custodian must send the IRA owner who is required to take an RMD for that year a statement either specifying the RMD amount or offer to calculate the RMD amount on request. However, IRA custodians are *not* required to do any reporting for inherited IRA accounts.

Inherited IRAs: While not legally required to do so, if the IRA custodian calculates and provides the RMD information to the inherited IRA beneficiaries, it has an obligation to do so in a non-negligent manner. Entering the wrong information in opening an IRA, or calculating an RMD using erroneous information, can lead to disastrous consequences. A recently filed lawsuit by a widow and her daughter demonstrates just how big that damage can be.

Lowe v. Wells Fargo, et al, Eastern District of Louisiana No. 23-7380 (Filed, December 21, 2023)

Facts Alleged: George Lowe created a trust in 1997. George named his wife as the sole income beneficiary of the trust. Ms. Lowe and her daughter (Ms. Sagaser) were named as the co-trustees of the trust. The trust contains an IRA owned by Mr. Lowe, made payable to the trust on his death. Mr. Lowe died on December 11, 2011. It appears that the trust is a *conduit trust* where all RMDs paid into the trust are, in turn, timely paid out to Ms. Lowe, the widow. Since 2001 the trust funds were managed by Wells Fargo, which also acted as the IRA custodian. The initial Wells Fargo advisor died in 2019. The successor advisor to the account shortly thereafter left Wells Fargo for a new firm, and the co-trustees followed their 'new' investment advisor.

In 2022, the 'new' advisor informed Ms. Lowe that the RMD for 2022 was significantly higher than it had been in the past when the IRA was managed by Wells Fargo. The new advisor suggested that Ms. Lowe contact her CPA to investigate the discrepancy.

The CPA found that when Mr. Lowe's trust was initially established back in 2001, someone had incorrectly entered the date of Ms. Lowe's birthdate, as January 1, 2001, and not her correct birthdate of October 31, 1939. Apparently, this error had never discovered, which resulted in smaller RMDs taken by the trust and paid out to Ms. Lowe for ten years after George's death. Since George had died after his required beginning date (RBD) Ms. Lowe, as the *see-through beneficiary of the conduit trust* had reached the age of 73 in 2012. Therefore, the RMD for that first

year after George's death should have been based on a 14.8-year life expectancy factor (from the Single Life Table in effect at that time. [That Table was updated starting in 2022.] Looking at the RMD from the erroneous birthdate used, the first RMD would have been calculated using a 71.8-year life expectancy (for an 11-year-old!) Thus, by way of example, what should have been an RMD of \$67,568 distributed in 2012 was, instead, only \$13,928. The CPA calculated that the Lowe trust had received about \$570,460 in total RMDs for the years 2012-2021, when the RMDs should have been \$842,767.

The IRS subsequently informed the Lowe trust that it owed more than \$130,000 in penalties for taking smaller-than-required RMDs for the 2012-2021 period. As set forth in her complaint against Wells Fargo and the investment advisors, Ms. Lowe apparently took the \$272,306 RMD 'shortfall' as a lump sum payment to stop the accrual of penalties.

Ms. Lowe and her daughter, as co-trustees, have filed a lawsuit against the two advisors claiming that they had acted negligently and breached fiduciary duties to the trust. The co-trustees also seek a recovery of the RMD penalty and other monetary damages.

Conclusion: One must wonder how an IRA custodian could mess up the age of the designated beneficiary by so many years, all of which led to the \$130,000 penalty for the failure to take the required minimum distribution. This is a good example of why Greenleaf wants to meet with its clients, face-to-face, each year so that mistakes like the one in the Lowe trust case can be quickly identified- did Ms. Lowe, age 73 in 2012, really have a life expectancy of 72 years?