

New Surviving Spouse Automatic Beneficiary Rule

Take-Away: A surviving spouse who inherits their deceased spouse's IRA can continue that inherited IRA (not roll it over) and gain some new benefits.

Background: The SECURE Act 2.0 created a new automatic feature that is intended to benefit younger surviving spouses. [Section 327 of the Act.] Unfortunately, there is little history available to determine what Congress intended with this new feature. The July 18, 2024, Proposed Regulations issued by the IRS has provided a bit more insight into the benefit that Congress hoped to provide with this new automatic feature. In its most basic form, Section 327 allows a surviving spouse to elect to be treated as the deceased employee for purposes of the required minimum distribution (RMD) rules.

Proposed Regulations: The Proposed Regulations provided that the surviving spouse can delay taking RMDs from the inherited IRA until the deceased IRA owner would have reached is/her required beginning date (RBD, currently age 73) when the IRA owner's death is before his RBD (which is April 1 of the year after attaining the age 73.) This result occurs *automatically*.

- **RMD Calculation:** When the RMDs start for the surviving spouse-inheritor, the survivor will calculate his/her RMDs using their own age and the Uniform Lifetime Table, which is the more beneficial table to calculate RMDs. The use of the Uniform Lifetime Table to calculate the survivor's RMD is a new feature intended to assist the surviving spouse. The Uniform Lifetime Table produces a smaller (taxable) RMD the survivor must take from the inherited IRA. In the past, prior to the Proposed Regulations, the surviving spouse could not use the Uniform Lifetime Table to calculate his/her RMD.
- **Inherited IRA:** When Section 327 applies, the IRA is still considered an inherited IRA account (not a spousal rollover to the survivor's own IRA.) This means that if distributions are taken from the inherited IRA by the spouse-beneficiary, no 10% early distribution penalty will apply. This change will be helpful to a younger surviving spouse-beneficiary who may need access to the funds held in the inherited IRA for his/her living expenses.
- **Spousal Rollover:** Even more beneficial, despite the *automatic* inherited IRA creation under Section 327, the Proposed Regulations clarify that the surviving spouse can make a spousal *rollover* to his/her own IRA at any time in the future.

Example: Will dies in 2024 in an auto accident. Will was age 43 at the time of his death. The beneficiary of Will's IRA is his spouse, Kate, who is age 47. Kate will not have to take any required minimum distributions (RMDs) from the *automatically* created inherited IRA until Will would have been required to start taking them (under the current rules, when Will reached the age 75.) This new rule will allow Kate to delay taking any RMDs for over 3 decades. When Kate does start taking RMDs from the inherited IRA, she will use her own age to calculate the RMD, but she will also have the benefit of using the Uniform Lifetime Table to calculate the RMD. If Kate has financial needs in the future, Kate can take distributions from the inherited IRA (albeit taxable) but without having to pay any early distribution penalty, regardless of Kate's age at the time of distribution. Moreover, Kate can at any time *roll over* the inherited IRA (from Will) to her own IRA, without any penalty.

Observation: Prior to Section 327 a surviving spouse had a tough choice to make. Either make a spousal *rollover* to the survivor's own IRA, but then if funds were needed in the future, distributions from that *rollover* IRA would trigger a 10% early distribution penalty, or leave the funds in the inherited IRA, from which distributions could be taken without incurring a 10% penalty, but then the survivor would also be stuck having to take annual required minimum distributions (RMDs.) Thus, a choice had to be made to *roll* a portion of the inherited IRA to the survivor's own IRA and leave the balance of the inherited IRA in place so funds could be accessed by the survivor without penalty to pay expenses incurred by the survivor, but then face annual taxable distributions from the inherited IRA. Now, with Section 327 *automatically* applying: (i) the surviving spouse can delay having to take any taxable distributions from the inherited IRA (much like a *spousal rollover IRA* that is used to delay taking taxable distributions to a much later date: (ii) if distributions are taken by the surviving spouse, there will be no 10% early distribution penalty faced by the surviving spouse, which would be the case if the funds had been *rolled over* to the survivor's own IRA; and (iii) when RMDs are finally taken by the surviving spouse from the inherited IRA, the more favorable Uniform Lifetime Table will be used to reduce the size of the taxable RMDs, must to the surviving spouse's benefit.

Conclusion: While I always yearn for simplified distributions rules that are easily understood, and Section 327 is just one more 'rule' to keep track of, it does provide far greater flexibility and benefit to a spouse who inherits an IRA or other qualified plan account. It is just the on-going challenge to understand, and remember, all of these complex distribution rules.

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