

Brief SECURE 2.0 Act Refresher: When Harry Left Sally

Quick-Take: Special distribution rules apply when a spouse dies naming his/her surviving spouse as the IRA's designated beneficiary.

Background: I was recently asked to clarify the changes that the SECURE 2.0 Act made to the options a surviving spouse has when named as the beneficiary of her deceased spouse. There are basically three options. For ease of description, assume that Harry dies, survived by his wife Sally.

Spousal Rollover: This is the most common option taken by a surviving spouse. By rolling over Harry's IRA, Sally becomes the owner of Harry's IRA. Sally's rollover election is **irrevocable**. If Sally needs to access the balance of Harry's IRA, let's hope that she is over the age 59 ½. If Sally withdraws funds from her rollover IRA, she will pay a 10% excise tax in addition to the income taxes on the amount that she withdraws from *her* IRA. If Sally is under the age 59 ½, and Harry did not leave her any other financial resources, e.g., life insurance proceeds, then Sally should not elect a spousal rollover, but she should continue as the designated beneficiary of Harry's IRA. That is because if Sally needs to access those funds to support herself and her children, as an inherited IRA, Sally can avoid paying the 10% excise tax (though she will still pay the income taxes on the distribution that she takes from the inherited IRA.)

Inherited IRA: As suggested above, if Sally does not elect to rollover Harry's IRA and make it her own, she will continue to be the designated beneficiary of Harry's IRA. In this situation, Sally can leverage the special required minimum distribution (RMD) rules that benefit a surviving spouse beneficiary. Sally, as a surviving spouse, is an **eligible designated beneficiary**. As noted above, Sally can access funds in the inherited IRA without paying the 10% penalty if she is under the age 59 ½. More importantly, due to the SECURE 2.0 Act, Sally does not face an immediate annual RMD from the inherited IRA. (More on that below.) A surviving spouse beneficiary, like Sally, is allowed to delay RMDs on Harry's IRA that she inherits until Harry would have reached his required minimum distribution (RMD) age. Note, also, that while Sally might start out treating Harry's IRA as an inherited IRA, Sally can also elect to remain as the beneficiary of the IRA (assume Sally is under the age 59 ½) and when she reaches that age, Sally can then roll over the balance of

the inherited IRA and make it her own IRA, and take funds from it without any penalty (tax, yes, penalty, no.)

Example: Sally and Harry are both age 45. Sally is a stay-at-home mother raising children. Harry dies in an auto accident. Sally has no income of her own, and Harry died without any life insurance. Sally will need to access Harry's IRA to support the family. Sally elects to treat Harry's IRA as an inherited IRA, (i.e., she does not elect to roll over Harry's IRA and make it her own.) Sally can access Harry's IRA without any 10% penalty. Fifteen years later, when Sally is age 60, she then does a rollover of the inherited IRA into her own IRA, and she can then name the beneficiaries of her own rollover IRA.

Treat the IRA as Spouse's Own: The third option available to Sally is the ability to treat Harry's IRA as her own. In doing so, Sally pretends as if she owned Harry's IRA all along. This is treated as a spousal rollover without actually having completed a spousal rollover (into her own IRA.) The tax treatment under this option is almost identical to Sally executing a formal spousal rollover. As such, this option is seldom used. It is most often used when Sally wants to maintain an existing IRA investment held in Harry's IRA, like an annuity, but she would not be able to do so if Harry's IRA account was closed.

Death Before Required Beginning Date: When Sally is making the decision on whether to keep Harry's IRA as an inherited IRA or do a rollover to her own IRA, different rules will apply depending on when Harry died, i.e., before or after his required beginning date (RBD.) Assume that both Sally and Harry were 45 years old when Harry died. Sally has two different payout options if she opts to maintain Harry's IRA as an inherited IRA, i.e., no rollover. One option is the 10-year distribution rule under the SECURE Act, with no annual distributions required for any of those 10 years until the 10th year after Harry's death. The other option is the *stretch* distribution over Sally's life expectancy, since Sally is an *eligible designated beneficiary*, but this requires annual RMDs calculated using Sally's life expectancy.

Proposed Regulations: In last summer's Proposed Regulations regarding the SECURE 2.0 Act, the IRS provided its interpretation of Section 327 of that Act. It confirmed that Sally can delay taking required minimum distributions (RMDs) until Harry would have reached his first year of RMDs. Thus, if Harry was age 45 when he died, his RBD would be when he

attained age 75. That is a long delay before having to take RMDs. These Proposed Regulations also allow Sally to calculate her RMDs using the IRS Uniform Lifetime Expectancy Table. This is another positive result for Sally when she elects to keep Harry's IRA as an inherited IRA, because the use of the Uniform Lifetime Expectancy Table will result in a smaller RMD, than if Sally had to use the IRS Single Life Expectancy Table.

Example: As noted above, Harry was age 45 when he died, as was Sally. Sally elects to continue Harry's IRA as an inherited IRA. Sally will not have to start taking RMDs from the inherited IRA until Harry's first RMD which would be at age 75 had he survived to that RBD age. This allows Sally to delay taking any RMDs from the inherited IRA for three decades. When Sally starts taking RMDs, she will use the Uniform Lifetime Table with her own age in 2050. The factor used to calculate Sally's RMD would be about 25.5. Had Sally been required to use the Single Life Expectancy Table, the factor used to calculate her RMD would have been 16.2.

As noted, Sally can immediately take distributions from Harry's IRA that she inherited without incurring any penalty, regardless of Sally's age. Sally can also elect to make a spousal rollover to her own IRA at any time; she may do so once she is age 59½ if she wants to consolidate the funds from the inherited IRA with her own IRA and she wants to pick her own designated beneficiaries. However, after her spousal rollover, Sally will be 'on her own' and she will have to follow the normal RMD rules.

Conclusion: A surviving spouse has options, especially so after the SECURE 2.0 Act. Note a rollover election is irrevocable. These new rules may not make much difference if the surviving spouse is close to his/her required beginning date, but for younger surviving spouses, these changes can make a big difference in when and how much required minimum distributions will have to be taken.

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