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Issues Relating to the SECURE Act in view of the Proposed Regulations - Part 3

Notice 2022-53

Background. In our April 14, 2022 newsletter, we discussed the proposed Treasury Regulations that were published in February 2022 (the “proposed regulations”), which provided 275 pages of rules relating to, and interpretations of, the SECURE Act. As noted in several prior newsletters, the SECURE Act, which became effective on January 1, 2020, made some significant changes to the “required minimum distribution rules” (the “RMD Rules”). The RMD Rules are the income tax rules that apply to distributions from qualified employee benefit plans and IRAs. The RMD Rules apply to (A) distributions from a qualified employee benefit plan (plan) or IRA to (i) the employee or retiree participating in the plan and (ii) the named owner of the IRA (the persons in (i) and (ii) individually referred to as the “participant”) during the participant’s life, and (B) distributions to beneficiaries of participants on the participant’s death (and on the deaths of those beneficiaries).

One of the significant changes made by the SECURE Act is that “designated beneficiaries” (DBs) were divided into two categories: (i) “eligible designated beneficiaries” (EDBs) and (ii) designated beneficiaries who are *not* EDBs (referred to as “Other Designated Beneficiaries” or “ODBs”). EDBs are (i) the participant’s spouse, (ii) a minor child of the participant, (iii) a disabled individual, (iv) a chronically ill individual, and (v) an individual not more than 10 years younger than the participant. Only EDBs are entitled to take distributions from the participant’s plan or IRA after the participant’s death using some sort of life expectancy distribution method. ODBs are subject to the new 10 year rule.

Distributions that must be taken from plans and IRAs are generally referred to as “required minimum distributions” (RMDs). As previously noted, due to the SECURE Act, ODBs are now subject to the new 10 year rule. The 10 year rule provides that 100% of the amount in the plan or IRA inherited by the ODB (hereafter simply referred to as an “inherited IRA” because most ODBs who are beneficiaries of the participant’s qualified plan move the inherited plan benefits to an inherited IRA) must be withdrawn by December 31 of the year that contains the 10th anniversary of the participant’s death. This is a significant acceleration of distributions from inherited IRAs in the case of ODBs compared to prior law. Under prior law, many ODBs were able to “stretch” the distributions from their inherited IRA over their life expectancy, which was often a very long period of time (such as over 40 years for an ODB in his/her 40s).

In particular, in April 2022, we discussed a certain portion of the proposed regulations that interpreted the new 10 year rule in a manner that was not expected: ODBs must take RMDs in years 1 through 9 following the year of the participant's death in cases in which the participant dies after his/her "required beginning date" (RBD). (Of course, ODBs must also withdraw 100% of the amount in their inherited IRA by the end of the 10th year following the year of the participant's death.) In general, the current RBD is April 1 of the year following the year in which the participant reaches age 72. While, prior to the SECURE Act, *all* DBs had to take RMDs each year, commencing the year after the participant's year of death, certain wording in the SECURE Act itself seemed to indicate that the new 10 year rule (i) would apply like the already existing 5 year rule (no RMDs until the end of the final year) and (ii) would apply whether or not the participant died before or after RBD. In other words, everyone *assumed* that when the new 10 year rule applied, an ODB would not be required to take any distributions from the inherited IRA until the very end of the 10th year following the year of the participant's death. The proposed regulations published in February 2022 said otherwise.

The biggest problem with the proposed regulations' interpretation of the SECURE Act is that they were not publicly released until February 2022, while the SECURE Act itself became effective on January 1, 2020. In general, the SECURE Act applies in the case of participants who die on or after January 1, 2020. Per the proposed regulations, if the participant dies on or after January 1, 2020 and after his/her RBD, ODBs must begin taking RMDs by December 31 of the year following the year of the participant's death. As noted, no one was aware that ODBs of participants who died in 2020 should have taken an RMD by December 31, 2021. Therefore, many (most?) ODBs in this situation did not take their RMD in 2021. Failure to take an RMD results in a 50% penalty! (The 50% under-distribution penalty, which is an excise tax provided by Section 4974 of the Internal Revenue Code [the "Code"], can be waived by the IRS for "reasonable cause" if the affected taxpayer files a correctly completed Form 5329.)

By the same token, per the proposed regulations, in the case of participants who died in 2021 after their RBD, ODBs would be required to take their first RMD by December 31, 2022.

Notice 2022-53. Fortunately, just this month, the IRS issued Notice 2022-53. This Notice is interesting for what it did *not* say as well as for what it actually did say. Per Notice 2022-53, if an ODB was required to take an RMD in 2021 (or is required to take an RMD in 2022) because the participant died (i) on or after January 1, 2020 and (ii) on or after his/her RBD, and that ODB failed to take (or fails to take) his/her RMD(s) applicable in those two years, the penalty for failure to take the RMD(s) is waived. Specifically, the Notice says, "the IRS will not assert that an excise tax is due under section 4974" in these cases). In addition, if the ODB already paid an excise tax for an RMD the ODB failed to take in 2021, the ODB may request a refund of the excise tax paid.

Notice 2022-53 also addresses certain types of qualified employee benefit plans known as "defined contribution plans" (an example would be a 401(k) plan). If the administrator

of a defined contribution plan failed to distribute RMDs to ODBs in 2021 and fails to distribute RMDs in 2022 per the February 2022 interpretation in the proposed regulations, that plan will not be treated as having failed to satisfy the applicable RMD Rules. This is important because, if a plan administrator takes action or fails to take action that violates the RMD Rules, the entire qualified plan becomes “disqualified” from the favorable provisions in the Code and regulations applicable to qualified plans. That type of consequence would negatively affect *all* of the participants of that plan.

What Notice 2022-53 did *not* say is that the IRS is withdrawing its interpretation of the SECURE Act to the effect that ODBs must take RMDs in years 1 through 9 following the year of the participant’s death if the participant dies on or after January 1, 2020 and on or after his/her RBD. The IRS is merely waiving the penalty for failure to take those RMDs in years 2021 and 2022. We must wait for final regulations to see whether the IRS is going to maintain its interpretation of the SECURE Act on this point.

Stay Tuned for Part 4 in this Series on SECURE Act issues.

A Heads Up. Certain tax exemptions are periodically adjusted for inflation. Although we will discuss this in January 2023 when these changes become effective, here are some:

1. The estate tax basic exclusion amount (i.e., estate tax exemption) will increase to \$12,920,000. Married couples who take some action (e.g., create and fund a “bypass trust” [a/k/a credit shelter trust] and/or timely make the portability election on the first spouse’s death) can utilize both spouses’ exemptions.
2. The lifetime gift tax exemption amount will increase to \$12,920,000. Because of our unified transfer tax system, the estate and gift tax exemptions are “synchronized” with each other. In other words, taxable gifts made during life use up some or all of the donor’s (gift-giver’s) lifetime gift tax exemption and, at the same time and to the same extent, use up some or all of the donor’s estate tax exemption.
3. The GST exemption amount will increase to \$12,920,000. Certain transfers made during life or at death are subject to the Generation-Skipping Transfer Tax (GST Tax).
4. The annual exclusion from the gift tax will increase to \$17,000 per donor (gift-giver) per donee (gift recipient). Married couples can give double this amount each year.

The holidays are fast approaching. HAPPY HOLIDAYS TO ALL!

Contact us:

If you have any questions about the material in this publication, or if we can be of assistance to you or someone you know regarding estate planning or probate matters, feel free to contact us by phone (713-520-5205), fax (713-520-5235) or email sent to:

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