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Retirement Planning

New RMD Rules: Focus on Eligible Designated Beneficiaries

Here is the latest installment in our series on how new IRS rules affect different categories of beneficiaries of inherited retirement accounts.

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On July 18, 2024, more than two years after releasing its proposed regulations applicable to required minimum distributions (RMDs), the IRS released its final RMD regulations. These final regulations amend the rules and regulations governing RMDs from qualified retirement plans, 401(k) plans, governmental 457(b) plans, and Individual Retirement Accounts (IRAs) to reflect changes made by the Secure Act of 2019.

The Secure Act of 2019 (Secure Act 1.0) brought massive changes to the payout rules and options applicable to inherited 401(k)s and IRAs. The most significant change was the elimination of the "stretch" IRA for most non-spouse beneficiaries referred to as a Non-Eligible Designated Beneficiary (NEDB) and replaced it with a new 10-year payout rule, while also creating a new beneficiary category—Eligible Designated Beneficiaries—who generally can continue to stretch distributions—the topic of this column.

Secure Act 1.0 created a new category of beneficiary—Eligible Designated Beneficiary (EDB). Now there are three categories of retirement account beneficiaries—each classification has its own unique set of RMD rules.

1. **Non-Designated Beneficiary**: A beneficiary without a life expectancy such as an estate, charity, or non-qualified trust. We covered this category in an August 2024 column.
2. **Non-Eligible Designated Beneficiary**: Any individual designated as a beneficiary. A NEDB excludes nonperson beneficiaries such as estates, charities, and certain trusts. We covered this category in an October 2024 column.
3. **Eligible Designated Beneficiary**: There are five types of EDBs including: surviving spouse, minor child of the account owner, disabled beneficiary, chronically ill beneficiary, and a beneficiary that is not more than 10 years younger than the account owner. Generally, an EDB can stretch distributions based on their single life expectancy.

Eligible Designated Beneficiary

The Secure Act of 2019 split designated beneficiaries (i.e., human beneficiaries) into two separate subcategories: Eligible Designated Beneficiaries (EDBs) and Non-Eligible Designated Beneficiaries (NEDBs). Why? NEDBs, which are mostly non-spouse beneficiaries (post-Secure Act), are subject to the new 10-year rule. Congress created the term EDB and differentiated this subcategory from NEDBs because such beneficiaries can continue to (post-Secure Act) "stretch" payments over their single life expectancy as opposed to requiring usage of the 10-year rule. An EDB can generally "stretch" distributions from a 401(k), 403(b), governmental 457(b) plan, traditional IRA, or Roth IRA following the death of a plan participant or IRA owner.

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Here are how the final regulations affect Eligible Designated Beneficiaries:

(1) Minors: This covers a minor child of the account owner who has not reached the age of majority as of the date of the account owner's death. A minor child of the account owner is considered an EDB and therefore can stretch an inherited IRA over their single life expectancy until reaching age 21.

- *A minor that EDB qualifies* and attains age 21: The child is considered to have reached the age of majority in that year. Once the child is no longer a minor, the entire account must be distributed to the child by December 31 of the 10th calendar year after the calendar year of the child's majority, unless the child satisfies a different EDB classification. Once this age (21) is reached, the 10-year clock begins; thus, the beneficiary will then take RMDs annually based on their single life expectancy.

  Notably, the final regulations' at least as rapidly requiring annual Required Minimum Distributions (RMDs) to continue, also apply during the 10-year period, regardless of whether the account owner (i.e., parent) died before, on, or after their required begin date (RBD).

- Per the IRS final regulations, the definition of a child includes a stepchild, an adopted child, or an eligible foster child under IRC Section 152(f)(1) when determining if a child qualifies as an EDB.
- The age at which minor reaches the age of majority under state law is irrelevant for the purpose of determining EDB eligibility. To determine if an individual is a "minor child of the decedent," they will be considered a minor until they reach their 21st birthday.
- In such cases where the account owner has named multiple minor children beneficiaries, a total distribution is not required until 10 years after the youngest of the account owner's children who are EDBs attains age 21.

Example: In 2025, Toni, age 10, inherits an IRA from her mom, Jacci, age 45. Toni, a minor child of Jacci, is an EDB and can therefore stretch distributions over her single life expectancy. The "stretch" will continue until Toni attains age 21 (age of majority) in 2036; the 10-year rule will then apply. Therefore, Toni must fully liquidate her inherited IRA by December 31, 2046 – (i.e., the end of the 10th year after she reached age 21.)

Importantly, even though Jacci (Toni's mother) died prior to her RBD for RMDs, Toni must continue to take annual RMDs for years 1-9 of her 10-year window.

(2) Disabled Beneficiary: This refers to beneficiaries who are disabled within the meaning of IRC Section 72(m)(7). When a beneficiary is deemed disabled (but for an indefinite period or what is reasonably expected to be lengthy in nature), they qualify as an EDB. Thus, they can stretch distributions over their single life expectancy.

- If, as of the date of the account owner's death, the individual has a "medically determinable physical or mental impairment that results in marked and severe functional limitations and that can be expected to result in death or to be of long-continued and indefinite duration," the beneficiary qualifies as an EDB.

  The final regulations, however, include a safe harbor definition, whereby an individual considered disabled by the Social Security Administration (as of the date of the account owner's death) will be deemed to meet the meaning of disabled for the purpose of being classified as an EDB. Alternatively, the beneficiary could produce other documents, such as a letter or note from a physician, confirming they are "unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration."

  Final regulations also provide a different definition of disability depending on the beneficiary's age. The definition of disability under IRC Sec. 72(m)(7) applies to individuals age 18 or older, whereas the regulations create simplified requirements for an individual under the age of 18 to be considered disabled for the purpose of being an EDB.

- An EDB, due to a disability, must provide the Plan Administrator with documentation no later than October 31 of the calendar year following the calendar year of the retirement account owner's death. Importantly, the final regulations exclude beneficiaries of inherited IRAs from this document requirement. Instead, this document requirement applies only to workplace employer-sponsored plans (i.e., 401(k).

A disabled beneficiary who inherited a retirement account after the Secure Act effective date but in years prior to 2024, is not exempt from the documentation requirement. Such beneficiaries, however, are granted an extension from the usual deadline of October 31 of the year after owner's death and instead, have until October 31, 2025, to provide the Plan Administrator with the necessary documentation.

If appropriate documentation is not provided timely, the beneficiary will not be deemed an EDB and will instead be classified a designated beneficiary and thus subject to the 10-Year rule.

(3) Chronically Ill Beneficiary: This refers to beneficiaries who are chronically ill within the meaning of IRC Section 7702B(c)(2). An individual who is chronically ill is considered an EDB if, as of the date of the account owner's death, the illness is "indefinite or reasonably expected to be lengthy in nature."

- Per the IRS Final Regulations, an individual will be treated as chronically ill under IRC section 7702B(c)(2) only if there is a certification from a licensed health care practitioner (IRC section 7702B(c)(4)) that, as of the date of the certification, the individual is unable to perform (without substantial assistance from another individual) at least two activities of daily living, and the period of that inability is an indefinite one that is reasonably expected to be lengthy in nature.
- A chronically ill beneficiary must provide the Plan Administrator with documentation no later than October 31 of the calendar year following the calendar year of the retirement account owner's death. Notably, the final regulations exclude beneficiaries of inherited IRAs from this documentation requirement. Instead, the document requirement applies only to workplace employer-sponsored plans (i.e., 401(k).

A chronically ill beneficiary who inherited a retirement account after the Secure Act effective date but in years prior to 2024, is not exempt from the documentation requirement. Such beneficiaries, however, are granted an extension from the usual deadline of October 31 of the year after owner's death and instead, have until October 31, 2025, to provide the Plan Administrator with the necessary documentation.

If appropriate documentation is not provided timely, the beneficiary will not be deemed an EDB and will instead be classified a designated beneficiary and thus subject to the 10-Year rule.

(4) Not-More-Than 10-Years-Younger Beneficiary: This refers to an individual who is not more than 10 years younger than the account owner.

- The determination of whether a beneficiary is 10 years younger is based on dates of birth as opposed to the attained age at the end of the calendar year.
- A not-more-than-10-years-younger designation includes a beneficiary who is older than the account owner.

(5) Sole Beneficiary Surviving Spouse: An individual is considered the surviving spouse of the account owner as of the date of the account owner's death.

- Surviving spouse must be the sole beneficiary to be considered an EDB.
- When the original account owner dies before their RBD, an EDB may take distributions based on their single life expectancy starting in the calendar year after the account owner's death. However, a sole spouse beneficiary can defer RMDs until the year after account owner would have attained their RBD for RMDs.
- When the account owner dies on or after their RBD, the surviving spouse must continue taking RMDs based on the life expectancy of either the deceased (account owner) or surviving spouse.

What Else Do I Need to Know About Eligible Designated Beneficiaries?

- IRS Final Regulations permit an EDB to choose between the "Stretch" or 10-Year rule. More specifically, an EDB can elect to receive (1) payment, beginning in the year after the account owner's death, using the beneficiary's single life expectancy or (2) liquidate the entire amount (from the inherited account) by the end of the calendar year including the 10th anniversary of the account owner's death.

Final Regulations, however, permit a workplace retirement plan to have different rules apply for different categories of EDBs. For example, a plan can allow a surviving spouse EDB to choose between the “Stretch” or 10-Year Rule while requiring all other EDBs to use the 10-Year Rule.

- When the original account owner dies before their RBD, an EDB can either choose to take RMDs over their single life expectancy (i.e., “stretch”) or the 10-year rule. Whereas when the account owner dies on or after their RBD for RMDs, an EDB can take RMDs based on the longer of their life single expectancy or that of the (now deceased) account owner. In other words, RMDs must satisfy the “at least as rapidly” rule (using the single life expectancy of the account owner or EDB, based on whoever was younger in the year of the account owner’s death).
- An account owner who dies before their RBD: An EDB who has not satisfied the “stretch” requirements may elect the 10-year payout rule no later than December 31 of the 9th calendar year following the calendar year of the account owner’s death, provided that the entire (inherited) retirement account is distributed (to the EDB) by December 31 of the 10th calendar year following the year of the account owner’s death.
- Specifically, these changes apply in the case of a plan participant or IRA owner who dies on or after January 1, 2020, and applies to a 401(a), 401(k), 403(b), or 457(b), traditional and Roth IRAs after December 31, 2019, and upon the death of a participant in a governmental 401(a), 401(k), 403(b), or 457(b) after December 31, 2021.

Questions? Please contact your Lord Abbett representative at 888-522-2388.

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A 401(k) plan is a qualified plan that includes a feature allowing an employee to elect to have the employer contribute a portion of the employee's wages to an individual account under the plan. The underlying plan can be a profit-sharing, stock bonus, pre-ERISA money purchase pension, or a rural cooperative plan. Generally, deferred wages (elective deferrals) are not subject to federal income tax withholding at the time of deferral, and they are not reported as taxable income on the employee's individual income tax return. A safe harbor 401(k) plan is similar to a traditional 401(k) plan, but, among other things, it must provide for employer contributions that are fully vested when made.

A 457(b) deferred compensation plan is a type of tax-advantaged retirement savings account that certain state and local governments and tax-exempt organizations offer employees.

A Roth IRA is a tax-deferred and potentially tax-free savings plan available to all working individuals and their spouses who meet the IRS income requirements. Distributions, including accumulated earnings, may be made tax-free if the account has been held at least five years, and the individual is at least 59½, or if any of the IRS exceptions apply. Contributions to a Roth IRA are not tax-deductible, but withdrawals during retirement are generally tax-free.

A Traditional IRA is an individual retirement account (IRA) that allows individuals to direct income, up to specific annual limits, toward investments that accumulate tax-deferred. Contributions to the traditional IRA may be tax-deductible depending on the taxpayer's income, tax-filing status, and other factors.

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