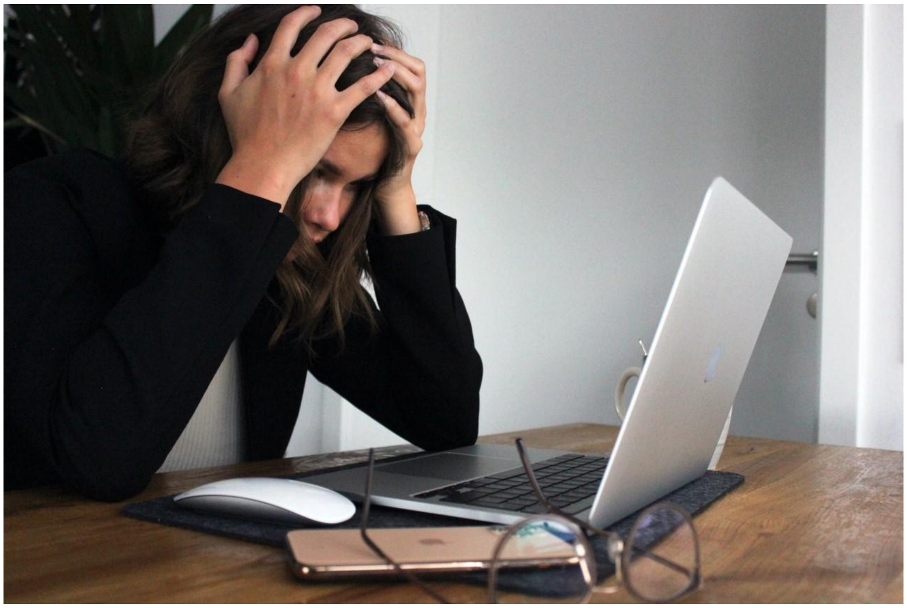
Inherited IRAs: Big headache, or big opportunity?



Don't be surprised if your clients are walking into your office in a state of bewilderment over something they've read recently about the IRS's distribution rules for inherited IRAs.

What's the back story?

Until the law changed a few years ago, a client who was named as the beneficiary of a parent's IRA, for example, could count on a relatively straightforward and tax-savvy method of withdrawals called the "stretch IRA." With the passage of the SECURE Act, that changed for many clients who inherited an IRA after December 31, 2019. Instead of taking distributions over their lifetimes, affected clients would need to withdraw the entire inherited IRA account within a 10-year period as calculated under the law.

What's the problem now?

Too bad about the loss of the stretch IRA, but we've all had time to adjust to the new IRS rules, right? Wrong. Unfortunately, the IRS rules are, at the moment, clear as mud. Concern escalated when the IRS issued proposed (but not yet final) regulations earlier this year. Advisors and clients are facing an acute discrepancy between what had been understood by practitioners immediately after the SECURE Act was passed, on one hand, and what the IRS has included in the proposed regulations, on the other hand.

Specifically, some non-spouse beneficiaries of an inherited IRA may not be able to wait until the 10-year post-inheritance mark to fully withdraw the funds in a lump sum, but instead, according to the proposed regulations, must begin taking annual distributions immediately following the inheritance and throughout the statutory 10-year period during which all funds must be withdrawn. This is a hard pill to swallow for clients who were counting on years of additional tax-free growth and who had hoped to defer an income tax hit until a lower-income year.

The situation is complicated but worth understanding (we like this very clear article) because of the potential headaches the proposed regulation could cause for your clients who are caught in the gray area.

A charitable giving opportunity?

The current state of confusion could present a golden opportunity to serve your philanthropic clients.

First, anytime you are talking about IRAs, inherited or not, you'll want to make sure your client knows about Qualified Charitable Distributions (QCDs). As tax enthusiasts, we may feel we talk about QCDs all the time. Hearing the message multiple times, though, is crucial in order for clients–who are likely not tax experts–to truly appreciate the benefits of the QCD.

As a reminder, through QCDs, a client who is 70½ or older can use a traditional IRA to distribute up to $100,000 ($200,000 for a couple) per year, which happily counts toward satisfying Required Minimum Distributions, to a qualified charity, including certain types of funds at the community foundation. The distribution is not reported by the client as taxable income because it goes straight to charity.

Second, for your clients owning inherited IRAs who are caught in the confusion of SECURE Act proposed regulations, a QCD could come in very handy. The IRS *does* permit taxpayers to make QCDs from inherited IRAs, not just their own IRAs. This option could be a welcome relief to clients who are facing the more stringent proposed IRS regulations governing the payout requirements for inherited IRAs.

Please contact us if you have questions about how your clients can use their IRAs to support their favorite charitable causes. We'd be glad to help.