Forbes

https://www.forbes.com/sites/juliejason/2023/04/28/inherit-a-roth-ira-watch-out-for-penalties-for-missing-rmds/

Inherit A Roth IRA? Watch Out For Penalties For Missing RMDs

Julie Jason, JD, LLM

Contributor

Apr 28, 2023,05:28pm EDT

Roth IRA owners don't have mandated withdrawal requirements during their lifetimes. But that's not the case for those who inherit a Roth IRA.

Since Roth IRA withdrawals are not subject to income taxation, you would think that there would be no penalties for failing to take a withdrawal when beneficiaries are required to do so.

However, if the inheritors fail to abide by RMD (required minimum distribution) rules, there is indeed a penalty, called an excise tax.

Important Caution

While I will offer general information, keep in mind that you will need a tax adviser to guide you. Tax advice can only be provided on a case-by-case individual basis that applies to your particular situation. Be sure to talk with your tax adviser about IRAs.

Some Roth IRA Basics

Roth IRAs are truly tax-advantaged, outcompeting traditional IRAs by far. Income and gains earned are not subject to taxation while the Roth is open. Nor are they subject to taxation when withdrawals are taken, as long as the Roth IRA in question has a five-year history (five years being measured from the first deposit). Further, the Roth IRA owner is not subject to RMDs during his lifetime.

What Happens When the IRA Owner Dies?

While the Roth IRA owner is not required to withdraw funds during his lifetime, when he passes away, the rules change. The beneficiary who inherits the Roth must follow Roth IRA RMD rules.

The beneficiary can wait until the year containing the 10th anniversary of the death of the owner before taking any withdrawals. But then, he needs to empty the Roth IRA by Dec. 31 of that 10th year (see Internal Revenue Code section 401(a)(9)(H)(i)(I)).

Different rules apply to spouses and "eligible designated beneficiaries," including situations where yearly RMDs are required (see Internal Revenue Code section 401(a)(9)(H)(ii)). An EDB is defined in IRS Publication 590-B as an IRA owner's "surviving spouse, the owner's minor child, a disabled individual, a chronically ill individual, or any other individual who is not more than 10 years younger than the IRA owner."

Inherited Roth IRA Penalty?

Considering that Roth IRA withdrawals are not taxable neither to the Roth IRA owner nor to the Roth IRA beneficiary, you may think it odd that a penalty applies if someone who inherits a Roth fails to take RMDs.

To get some insight, I reached out to Ted Ginsburg, director and head of the Compensation and Benefits Tax Practice at Marcum LLP, a national accounting and advisory services firm.

It comes down to regulations.

"The Treasury Regulations which impose the penalty for failure to take a required minimum distribution specify that Roth IRAs are included," Ginsburg said, citing Treasury Regulation 54.4974-2 at A.2.

The rationale is similar to the policy for requiring a traditional IRA distribution when the RMD age is reached:

"Congress does not want funds accumulating in qualified plans (including IRAs and Roth IRAs) because that would defer taxation on the earnings in those plans as well as the principal of the plans (not the case with Roth IRAs).

"The government wants the funds in those accounts circulating in the economy, instead of merely accumulating for distribution to the descendants/beneficiaries of the account holder," Ginsburg explained.

New Penalties for 2023

Until tax year 2023, the penalty (excise tax) for an RMD shortfall was 50% of the amount of an RMD that was not taken by the end of the calendar year in question. For example, a failure to take a $50,000 RMD resulted in a penalty of $25,000 under the old rules.

That 50% penalty is now history. SECURE Act 2.0, which was enacted at the end of 2022 as part of the Consolidated Appropriations Act, 2023, reduced the 50% penalty to 25%, and further to 10% in "certain cases." If you miss an RMD in 2023, this change in the law applies to you (effective beginning in tax years after Dec. 29, 2022).

'Certain Cases'?

As I mentioned, the 25% penalty can be reduced to 10% in "certain cases," which requires two things: actually making up the shortfall RMD (withdrawal) and timing. Basically, if you make up the shortfall timely, the penalty can be reduced from 25% to 10%. But keep in mind that it can also be waived if you have "reasonable cause." (More on that below.)

Timing depends on meeting the requirements of a new term, the "correction window."

Quoting from Pub. 590-B, the correction window is "the period of time beginning on the date on which the excise tax is imposed on the distribution shortfall and ends the earliest of the following dates:

"The date of mailing the deficiency notice with respect to the imposition of this tax; or

"The date the tax is assessed; or

"The last date of the second taxable year that begins after the date of the taxable year in which the excise tax is imposed."

Perfectly clear?

We'll talk more about correction windows in a future post. But first, let's talk about penalty waivers.

Reasonable Cause?

If you find yourself having inadvertently missed an RMD as the beneficiary of a Roth IRA, there is a possibility that the penalty can be waived. For that to happen, you have to show "reasonable cause."

The proper IRS form to use to request a waiver is IRS Form 5329. Be sure to read the instructions for Part IX (for example, you'll want to write "RC" for reasonable cause and the amount of the shortfall in parentheses next to line 54 of the form). You will also need to attach a letter explaining your justification for reasonable cause – and, of course, don't forget to take the RMD (or the shortfall).

Part IX states that the IRS "can waive part or all of [the penalty] if you can show that any shortfall in the amount of distributions was due to reasonable error and you are taking reasonable steps to remedy the shortfall."

"The IRS will review the information you provide and decide whether to grant your request for a waiver," quoting the instructions for Form 5329. "If your request is not granted, the IRS will notify you regarding any additional tax you may owe on the shortfall." Note that if you file Form 5329 by itself and not at the same time as you file your taxes, you cannot file it electronically, according to the IRS.

Questions?

To keep up with topics that I cover, be sure to *follow* me on the forbes.com site (and if you would like to *subscribe*, check out the red box at the top right). Write to me at **forbes@juliejason.com**. Include your city and state, and mention that you are a forbes.com reader. *While all questions cannot be answered, each email is read and reviewed and can lead to discussion in a future post.*