

NEW LAW MAY LOWER RMDs WHEN ANNUITY IS ANNUITIZED – BUT IRS GUIDANCE NEEDED

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If you are subject to required minimum distributions (RMDs) and have annuitized part of your IRA, a recent law change could drastically reduce your RMDs. But, without IRS guidance, it may be difficult to take advantage of that change.

When an annuity within an IRA is annuitized, RMDs are calculated differently than they are for the non-annuitized IRA portion of that IRA (or of other IRAs you own). For the non-annuitized portion, you divide the prior-year account balance by your life expectancy factor under the IRS Uniform Lifetime Table. But for the annuitized part, the annuity payments you receive during a year are considered the RMD for that year.

Typically, this annual amount is larger than the RMD that would be required if the annuitized portion of your IRA was determined under the non-annuitized RMD method (i.e., prior-year account balance divided by life expectancy). However, under the rule in effect before SECURE 2.0, you couldn't credit this overage against the RMD for the non-annuitized part of your IRA. In other words, you had two separate RMDs – one for the annuitized part of your IRA portfolio and one for the non-annuitized part.

Example 1: Amy turned age 73 this year and is required to take a RMD for 2023. In late 2022, Amy purchased an annuity with \$250,000 of her funds in IRA-A that will start paying her a monthly benefit of \$1,250 in January 2023. As of December 31,

2022, Amy also has \$200,000 in IRA-B which is invested in mutual funds. For 2023, Amy will receive \$15,000 ($\$1,250 \times 12$) of annuity payments from IRA-A, and that will satisfy her RMDs for IRA-A. However, under the old RMD rule, Amy would also have to take a separate RMD of \$7,547.17 ($\$200,000/26.5$) from IRA-B.

SECURE 2.0 changes this rule. Starting in 2023, you can get credit for the fact that the annuitized portion produces a higher RMD than if that portion wasn't annuitized. To use the new rule, you combine the value of the annuitized and non-annuitized portions of your IRA portfolio as of the end of the prior year and divide that sum by your applicable life expectancy factor. This becomes your total RMD for the year. You then subtract the annual annuity payment from the combined RMD to determine how much of the total RMD remains and must be taken from the non-annuitized portion.

Example 2: If the value of Amy's annuity as of December 31, 2022 was \$250,000, under the new rule, her total 2023 RMD would be \$16,981.13 [$(\$250,000 + \$200,000)/26.5$]. \$15,000 of that total RMD would be satisfied by the IRA-A annuity payments, requiring Amy to take only \$1,981.13 from IRA-B. This is about \$5,500 less than under the old rule.

So, what's the problem? The problem is that you need a valuation of the annuity to use the new RMD rule, and SECURE 2.0 doesn't say how to obtain that valuation. The insurance company is supposed to report to you the fair market value of your annuity annually on Form 5498. But once an annuity is annuitized, that doesn't always happen or, if it does happen, the reported valuation may not be one you can rely on. So, until we get IRS guidance on what constitutes a proper valuation, it may be challenging for you to take advantage of the new RMD rule.

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