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Sales Tax Considerations Impacting the Pop-Up Art Markets Across the United States

In the aftermath of the COVID-19 pandemic when many art galleries were closed and art fairs and shows were canceled indefinitely, the latter are seeing a comeback across the United States and particularly in major art markets such as California, Florida and New York. The art pop-up provides both the burgeoning artist and seasoned art dealer a space to engage with art enthusiasts looking to expand their collection and first-time buyers who are stepping excitedly into the art world. Shows like the Superfine Art Fair in Los Angeles, Miami, New York City and San Francisco bring together over 130 emerging artists from across continents and targeted and prequalified buyers over a four-day period. Art Basel, held annually in Miami, provides a space for renowned and emerging art galleries to exhibit modern and contemporary pieces.

So, what should an artist or art gallery consider when selling art at an art fair or show? Below, are outlined the key sales tax considerations for artists and galleries selling artwork in these spaces in California, Florida and New York.

Sales Tax Vendor Registration Requirements

Does an artist or gallery participating in an art fair or show need to register as a vendor in the jurisdiction for sales and use tax purposes?

California

In general, in-state retailers with a permanent place of business in California who sell three or more items of tangible personal property (including artwork) in California are required to register as a seller and remit California sales tax.

However, retailers with no permanent place of business in California who sell artwork at a location in California for less than 90 days are considered temporary sellers and are required to obtain a temporary seller's permit.

Sellers can submit the registration application for either a permanent or temporary sales tax license at the California Department of Tax and Fee Administration website here. Sellers requesting a temporary license may submit the application up to 90 days before the date of the art fair or show and must list each temporary location at which the seller will be operating during the 90-day period.

Florida

Every person importing, producing, or otherwise selling tangible personal property (including artwork) for sale in Florida must register as a dealer and assess, collect and remit Florida sales and use tax. This registration, collection and remittance requirement is applicable to dealers with a permanent place of business in Florida or dealers who are temporarily selling tangible personal property in Florida. Florida does not have a temporary vendor status.

Persons conducting business in Florida as a dealer can register either by mailing Form DR-1 or electronically submitting the Business Tax Application here.

New York

In-state persons selling tangible personal property (including artwork) in New York are required to register as a vendor and assess, collect and remit New York sales and use tax. In addition, persons with no permanent place of business in New York who are selling tangible personal property (including artwork) at shows such as, flea markets, craft shows and antique shows must also register as a vendor in New York. These persons are subject to the same collection and remittance requirements as in-state persons with a permanent place of business in New York. New York no longer offers a temporary Certificate of Authority to show and entertainment vendors.

All vendors must register in New York for sales and use tax purposes at least 20 days prior to commencing business in the state. Persons conducting business in New York as a vendor should register electronically via New York Business Express here.

Assessing the Proper Sales Tax

How does a vendor determine the proper sales tax rate?

California

California imposes a state sales and use tax and localities impose district sales and use taxes. The state tax rate equals 7.25%. However, if the seller ships the artwork to or on behalf of the purchaser outside of California using a common or contract carrier, customs broker or forwarding agent, the seller is not required to collect California sales tax.

District sales tax rates vary and apply when the purchaser takes possession of the artwork in a particular district or the artwork is delivered to a particular district. Sellers can look up California state and district sales and use tax rates by entering a street address here. As an alternative, a listing of current and historical tax rates can be found here.

Florida

Florida imposes a state sales and use tax and in-state localities impose sales and use surtaxes as well. The state tax rate equals 6%. However, if the seller ships the artwork to or on behalf of the purchaser outside of Florida by common carrier or United States mail, the seller is not required to collect Florida sales and use tax.

Local surtax rates vary and apply when the purchaser takes possession of the artwork in a locality that imposes a surtax or the artwork is delivered to the purchaser in a locality that imposes a surtax. However, the surtax is not imposed on sales of tangible personal property in excess of $5,000. Florida's local surtax rates can be found in Form-15DSS.

Florida law makes clear that dealers cannot communicate to purchasers, whether directly or indirectly, that the dealer will pay the sales tax on behalf of the purchaser or will not assess sales tax on the sale of the artwork.

New York

New York imposes a state and local sales and use tax. The state tax rate equals 4%.

Local sales and use tax rates vary and apply when the purchaser takes possession of the artwork or the artwork is delivered to the purchaser in a New York State locality. The New York local sales and use tax rates can be found here.

Also, sales where the purchaser takes possession of the artwork in or the artwork is delivered to the Metropolitan Commuter Transportation District (MCTD), are subject to an additional sales and use tax. The MCTD includes the counties of Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk, Westchester and New York City. The additional MCTD sales tax rate equals 0.375%.

Similar to Florida, New York law prohibits vendors from communicating to purchasers that the vendor will not assess or will credit the sales tax on the sale of the artwork.

Sales Tax Compliance

How does the vendor remit the sales tax collected?

California

In-state sellers must file a California sales and use tax return based on their assigned filing frequency and due date to report and remit collected California sales and use tax. Sellers may be assigned a quarterly prepay, quarterly, monthly or yearly filing frequency depending on the seller's estimated taxable receipts or sales tax liability.

Temporary sellers must file a California sales and use tax return no later than the last day of the month after the close of the art fair or show. For instance, if the last day of the art fair or show is November 25, 2022, the temporary seller must report and remit collected California sales and use tax no later than December 31, 2022.

Florida

Dealers must file a Florida sales and use tax return based on their assigned filing frequency and due date to report and remit collected Florida sales and use tax. Dealers may be assigned a monthly, quarterly, semiannual or annual filing frequency depending on the estimated dollar value of the dealer's annual sales tax collection. Dealers must file a Florida sales and use tax return even if the dealer has zero dollars in Florida sales.

New York

Vendors must file a New York sales and use tax return based on their assigned filing frequency and due date to report and remit collected New York sales and use tax. Vendors may be assigned a part quarterly/monthly, quarterly, or annual filing frequency depending on the vendor's estimated taxable receipts or sales tax liability. New vendors are typically assigned a quarterly filing frequency. Poignantly, show vendors must file a New York sales and use tax return even if the vendor did not participate in a show or make any sales for the sales tax period.

Vendor Compliance Obligation Post Event

How does an artist or gallery participating in an art fair or show properly exit the jurisdiction for sales and use tax purposes?

California

Since California provides a temporary sellers permit which expires after the 90-day period, there is no formal exit process for temporary sellers.

Florida

Dealers can inactivate their sales and use tax account if the dealer is temporarily suspending business activities in Florida and plans to resume activities in the future. Dealers can also cancel their sales and use tax account if the dealer is permanently discontinuing business activities in Florida. Either change is made by notifying the Florida Department of Revenue electronically here.

New York

Generally, when a vendor ceases doing business or participating in shows in New York, the vendor must file a final return and surrender the Certificate of Authority to the New York State Department of Taxation and Finance within 20 days.

The Takeaway

As the trend for pop-up art sales continues to grow, the sales tax compliance matters for artists, galleries and other vendors needs to be closely followed to prevent unexpected sales tax obligations. While this review covers the basics, there are a number of other nuances embedded in state sales tax law that need to be considered, particularly in light of the fact that state rules often vary across jurisdictions.

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How The Accelerating Charitable Efforts Act May Impact Charitable Giving

Two private charitable endowments frequently used by high-net-worth taxpayers are Donor Advised Funds (DAFs) and private charitable foundations. Due to their popularity in recent years and potential for abuse, both have become areas of review for Congress. In February of this year, U.S. Representatives Chellie Pingree (D-ME) and Tom Reed (R-NY) introduced The Accelerating Charitable Efforts Act (ACE Act) to ensure more charitable funds flowed quickly to nonprofit organizations by restructuring the rules surrounding private foundations and DAFs. Similar to other recently proposed legislation, the ACE Act attempts to correct two perceived abuses. First, the ACE Act seeks to resolve the timing discrepancy between when the donor receives a tax deduction for funding a DAF or private foundation versus when the charitable organization receives the grant. Second, it attempts to limit the concern over donor control in perpetuity.

As the law currently stands, the donor receives an immediate tax benefit when donating to either a private foundation or a DAF in the form of a deduction. However, the actual use of the donated property could potentially be delayed for years. Private foundations are typically required to distribute 5% of their endowments each year whereas DAFs have no minimum requirement on payout of donated funds and no deadline by which they must be depleted. Essentially, both private foundations and DAFs are allowed to hold funds for extended periods of time, delaying the charitable activities that allowed for the deduction on the donor's tax return in the first place.

Below is a summary of some of the provisions contained in the ACE Act as they apply to DAFs and private foundations.

Donor Advised Funds

There are three new categories proposed within the ACE Act for current and newly created DAFs. The two primary goals are to increase annual distributions to charities, while simultaneously limiting the time during which funds can be held.

Qualified DAF (QDAF)

Under the ACE Act, a QDAF requires advisory privileges to end after a 15-year period. Further, for a donor to receive a deduction, all funds donated must be distributed by the last day of the 15-year period. Any remaining portion would be subject to a 50% excise tax (essentially a recapture on the initial charitable deduction). Under current law, while the funds given to DAFs are irrevocably given to a sponsoring charity, donors are permitted to retain certain advisory privileges allowing donations to other charities based on the recommendation of the donor. There is however no requirement that any amount of a DAF be distributed to an outside charity. In addition to these changes, contributions of assets that are not publicly traded, in other words, fair market value of these assets are not on an established security market, would not provide the donor with a charitable deduction until the charity sells that specific contributed asset.

Qualified Community Foundation DAFs (QCFDAF)

A QCF is an organization described in Sec. 501(c)(3) as a public charity focused on supporting a specific geographical area by facilitating and pooling donations used to address community needs by supporting local nonprofits. They typically include scholarships, grants, DAFs and other endowments. A QCFDAF would be held by a qualified community foundation where each person with advisory power does not have such privileges over DAFs with an aggregate value at any time to exceed one million dollars. A QCFDAF can also be a DAF established with an agreement requiring qualifying distributions equal to at least 5% of the value as of the last day of the prior calendar year.

Nonqualified DAFs (NQDAF)

Put simply, a NQDAF is one that is neither a QDAF nor a QCFDAF. A donor is not allowed a charitable deduction until the organization makes a qualifying distribution and the amount of the deduction is limited to the amount of the qualifying distribution. If the donor's gift is property, rather than cash, no deduction is allowed until the organization sells the property for cash and makes a distribution of the proceeds. Any contribution to a NQDAF not distributed within 50 years is subject to a 50% excise tax.

Private Foundations

The first proposed change deals with administrative expenses and seeks to limit what is considered a qualifying distribution. Currently, salaries paid to employees of private foundations count as qualified distributions for meeting the 5% minimum distribution test. However, the ACE Act would limit this allowance. The act proposes that administrative expenses paid to disqualified persons will no longer count toward meeting the minimum distribution requirement. Disqualified people generally will include employees who substantially contributed to the foundation, family members, and certain other people considered insiders.

Other changes proposed, rather than limiting giving power, incentivize giving more quickly. Currently, private foundations are required to give 5% of average net assets annually and pay a flat rate tax of 1.39% on all investment income. Under the ACE Act, private foundations would be exempt from this tax in years they make qualifying distributions of 7% or more of net assets. Further, limited duration foundations, those set to have a legal existence of less than 25 years, would also be exempt from paying the 1.39% tax. Private foundations making distributions to other private foundations are not eligible for the exemption from tax. A recapture of the avoided excise tax would be required should any foundation give to a related foundation or should a limited duration foundation extend beyond the 25-year limitation.

The Takeaway

Although the ACE Act has not made its way through the legislative process, its proposal, along with other bills like it looking to curb perceived abuses relating to DAFs and private foundations, shows this is an area of concern for Congress. Given the prevalence of these entities among the charitably inclined, any developments related to this bill or others like it should be closely monitored.

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Foreign Tax Credits for Individuals: Common Oversights Can Result in Missed Opportunities

For individuals with international tax obligations, identifying and capitalizing on every foreign tax credit opportunity can be hugely complex. Key opportunities must be captured on the return without inadvertent oversights that can lead to significant risk.

It is critical that taxpayers be aware of key issues related to foreign tax credits to help guarantee they are timely and properly capturing key opportunities and making adjustments for prior years where possible. Below are opportunities that are commonly overlooked or misunderstood with respect to foreign tax credits.

Issue 1: Foreign Tax Deduction

For individuals who pay foreign taxes, the foreign tax credit is typically considered. However, many overlook the possible benefits of claiming foreign taxes as an itemized deduction or mistakenly assume the deduction is limited to the $10,000 cap on state and local taxes. While a foreign tax credit can allow a dollar-for-dollar (100%) reduction in U.S. federal income tax (other than the net investment income tax), and a deduction is limited to a taxpayer's effective U.S. tax rate (current maximum rates of 37%), the deduction can nonetheless be preferable under appropriate circumstances. This situation typically occurs because of the foreign tax credit limitation under Sec. 904, which limits the credit to the U.S. tax imposed on a taxpayer's net foreign source income on a category-by-category basis. Choosing to claim a credit in a tax year that the deduction provides a lower current year U.S. tax liability can prove costly. A strong expectation that sufficient foreign source income will be available in a later year to utilize the credit via carryforward (10 years are currently permitted) can overshadow serious consideration of the benefits of claiming the deduction.

Reviews of returns with carryforwards that remain within the three-year statute of limitations for possible amendment to a foreign tax deduction can result in refunds while also allowing for the 10-year statute to be utilized if the credit method does ultimately prove beneficial during the allowable carryforward period.

Circumstances that may lead to the beneficial use of foreign deductions vs. credits include:

- Different U.S. and foreign sourcing methods (e.g., U.S. considers income to be U.S. sourced but foreign country considers income to be non-U.S. sourced);
- Losses/deductions allowed for U.S. purposes restrict net foreign source income (but may not be permitted for foreign purposes);
- Foreign taxes triggered via remittance or distribution in a year after the underlying income is recognized for U.S. purposes;
- Foreign audits/assessments for those on the paid method; or
- K-1 allocations (e.g., foreign loss allocations in years foreign taxes are paid).

Issue 2: Paid Method vs. Accrued Method

While individual taxpayers typically capture income and deductions on the cash method, they can elect to determine creditable foreign taxes each tax year on the accrued method. Once the accrued method has been elected, the paid method may not be used in later tax years. Further, if the paid method is used, taxpayers are generally not permitted to change to the accrued method on an amended return if it is later determined that the accrued method would have been beneficial. Taxpayer facts and circumstances can lead to the paid or the accrued method resulting in a higher creditable foreign tax amount from year to year. It's thus important to get it right on the original return (without a crystal ball).

Issue 3: Section 911 Interaction, *Scaledown* of Creditable Tax Amounts

It can be beneficial for taxpayers who incur foreign taxes on foreign earned income, and those who qualify to exclude certain foreign earned income from U.S. gross income under Sec. 911, to nonetheless not claim the exclusion. This conclusion may seem counterintuitive at first blush.

If the exclusions are claimed, the foreign taxes attributable to excluded amounts are not creditable and must be *scaled down* on Form 1116. A scaledown amount that exceeds the U.S. federal income tax that would otherwise be imposed on excluded amounts can be a sign that the exclusion may not be beneficial. Revoking the exclusion on current or past returns (via amendment) may result in a tax savings. Similarly, overlooking the scaledown requirement, or calculating improperly, will often be easily identified by IRS and can lead to penalties and interest for the taxpayer.

Issue 4: Utilizing Carrybacks

Creditable foreign taxes that are not utilized in the year paid or accrued (depending on the taxpayer's method) due to the foreign tax credit limitation may be carried back one year and forward 10, in that order. While carryforwards are almost always considered as part of return preparation, refund opportunities via foreign tax credit carrybacks are often overlooked. Technically, creditable taxes that could have generated credits via carryback, but that are not actually carried back, are not available for carryforward. Taxpayers may not only leave refunds uncollected for carryback years but also falsely believe such taxes remain available for carryforward. Taxpayers can review current and past returns for carryback potential and to limit exposure that can result in overstated carryforwards.

Returns that can be amended to utilize carrybacks, whether attributable to foreign taxes or foreign source income not previously documented, should be prepared as soon as practically possible to limit the chances of continued oversight and missed opportunity. If decisions are made to specifically not claim available carrybacks based on limitations relevant in a carryback year, carryforwards should be specifically reduced.

Issue 5: State Considerations

Some U.S. states allow for credits or deductions related to foreign taxes of residents of the state. Such state benefits may be overlooked due to the focus on federal benefits. Most states that do allow a benefit only permit a credit or deduction if the same is claimed/elected for federal purposes. For example, a state may allow a foreign tax deduction but only if the taxpayer claims a foreign tax deduction (vs. a credit) on the federal return. The combined benefit from a federal and state foreign tax deduction should be considered when choosing between claiming a credit or a deduction for federal purposes.

As a note, states are not parties to U.S. income tax treaties, though state law may specifically allow for recognition of benefits available via treaty at the federal level.

The Takeaway

Understanding the complex rules related to foreign tax credits can ensure key opportunities are considered and timely captured. Taxpayers may find that amendment of past tax returns can effectively capture opportunities not previously recognized on original filings.

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Sponsoring Employees for Green Cards? Beware of Tax Traps

Many companies offer the option of sponsoring U.S. green cards for their employee(s) who may otherwise qualify to work in the U.S. under a nonimmigrant visa. This is often seen as an added perk when hiring and can be a benefit in retaining talent. While green card sponsorship may be attractive to company employees, it may not always be the best option for employers. Many employers and advisors focus on the immigration implications when it comes to green card sponsorships; however, they also need to be alert to hidden tax exposures.

Benefits of Green Card Sponsorship to Employees

Green cards are often preferred by employees because of the perceived personal benefits they can provide that a nonimmigrant work visa would not. These perceived benefits may include:

1. Faster processing by border authorities upon entry to the U.S.;
2. Ability to remain in the U.S. without an employer-sponsored work visa (including ability to remain in the U.S. and not work at all or work for an employer who is less able to sponsor a work visa);
3. Possible path to citizenship; and
4. Related benefits for accompanying family members.

Taxation of the Expenses Incurred from the Sponsorship Process

An initial consideration is whether immigration-related expenses of sponsoring an employee for a green card creates a taxable fringe benefit to the employee for U.S. tax purposes that fees for a nonimmigrant work visa would not.

The fees incurred to sponsor employees (and families) for green cards are often much higher than the fees related to nonimmigrant work visas. While companies sponsoring green cards may accept these additional fees, they may not appreciate or budget for the additional exposure to employment taxes (including possible gross-ups). Further, sponsorship through nonimmigrant visas may be a preferred way for an employer to retain talent in situations where the sponsored employee may otherwise resign if they are not able to remain in the U.S. with a green card.

Company Policy Considerations for Green Card Sponsorships

Employers, as well as immigration and tax advisors, often hold and communicate a belief that green card holders are taxed in the same manner as U.S. citizens and other resident aliens. However, this belief is not always the case and can lead to unintended and unforeseen consequences for both the employer and employee.

Employee tax consequences that can occur as a result of holding a green card (vs. a nonimmigrant visa) can include:

1. Taxation as a U.S. tax resident regardless of physical presence in the U.S., including taxation of worldwide income, until and unless Form I-407 is filed (expiration of a green card for immigration purposes is not relevant for federal tax purposes).
2. Possible presumption of U.S. domicile for U.S. transfer tax purposes and for residence in states that are tied to domicile status in the state.
3. Limited tax treaty benefits (for example: related to participation in foreign pension plans while working or residing in the U.S., and double tax exposure for certain residents of treaty countries).
4. U.S. expatriation consequences for long-term green card holders who voluntarily relinquish status via filing Form I-407 (including those who are “strongly encouraged” by immigration authorities to sign if residing outside the U.S.), or who claim foreign residence under a U.S. income tax treaty (even if the green card is retained and even if a taxpayer has a re-entry permit). Long-term green card status is generally met once an individual has held a green card in any portion of eight calendar years.

Green card employees affected by the above tax issues may assume that the sponsoring company is responsible for handling or look to the sponsoring company for relief for any unforeseen expenses incurred or additional taxes due. As a result, companies must understand these U.S. tax consequences and should carefully consider alternatives to green card sponsorship to avoid these issues.

If a company does choose to sponsor green cards for their employees, the company should consider protective measures when sponsorship does occur. Protective measures include clearly communicated policies and agreements with employees.

A protective measure may be part of a relocation or assignment policy, a tax reimbursement policy and/or an employment agreement. It may also include setting criteria for which employees will be sponsored, delaying sponsorship, and establishing clear policies to protect the company from perceived or contractual liability for related tax consequences the employee may incur.

Examples of protective measures include:

1. Employee understands and accepts sole responsibility for any tax consequences related to obtaining, retaining and relinquishing a green card. Company sponsorship of a green card is not implied and not an express agreement of responsibility by the employer for employee tax consequences, direct or indirect.
2. Tax equalization or other tax reimbursement policy does not cover tax consequences related to green cards sponsored by the company or otherwise. Tax equalization and reimbursement will be limited to costs that may have occurred under a nonimmigrant visa for non-U.S. citizens.
3. Employees are solely responsible for seeking personal tax advice related to green cards, and for clearly communicating green card status to advisors.
4. Green card holders who undertake permanent or temporary transfers outside the U.S. are personally responsible for adverse tax consequences related to the green card. Green card holders who undertake non-U.S. assignments are not necessarily eligible for tax reimbursement policies in the same manner as U.S. citizens or other foreign nationals.
5. Green card holders (current and former) are personally responsible for tax and information filing requirements that apply as a result of having obtained a green card.

It can be preferential from a tax perspective for an employee to delay obtaining a green card and remain in the U.S. on a nonimmigrant visa for as long as possible. It could also be beneficial for an employee to terminate their green card status (even if remaining in the U.S. on a nonimmigrant visa).

The Takeaway

It is important to understand the pros and cons of sponsoring a green card as there could be tax implications to the employee and company for obtaining, holding and relinquishing a green card. Policies should be carefully designed to protect companies from liability for employee tax and other consequences unique to green card holders.

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Navigating the New Required Minimum Distribution Rules for IRAs Inherited After 2019

The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), signed into law on December 20, 2019, set forth new rules with respect to required minimum distributions (RMDs) from tax-qualified retirement plans, including individual retirement accounts (IRAs). The SECURE Act changed certain rules with respect to the tax treatment of inherited traditional IRAs, most notably eliminating the ability of most beneficiaries to take distributions over their own life expectancy. Tax planning in respect of inherited IRAs became even more complicated as a result of proposed rules issued by IRS in February 2022 implementing the changes made by the SECURE Act (the proposed regulations).

RMDs are minimum amounts that an employee or IRA owner must withdraw annually from a qualified plan upon attainment of a certain age or retirement. A beneficiary of an employee or account owner is also subject to the RMD rules. Individuals who fail to take an RMD face a potential excise tax of 50% on the undistributed amount.

Changes Under the SECURE Act

The SECURE Act made several important changes to the RMD rules, including increasing the age at which RMDs commence from 70 ½ to 72 years. Additionally, for most beneficiaries, the SECURE Act eliminates the option to spread withdrawals over the life expectancy of the beneficiary (often referred to as “stretch” payments), limiting the payout period in most situations to ten years (10-year payout rule). The elimination of the stretch payment option does not apply to a new classification of beneficiaries referred to as “eligible designated beneficiaries” and they can continue to spread withdrawals over their life expectancies. The definition of eligible designated beneficiary includes:

- a surviving spouse,
- a minor child,
- a disabled person,
- a chronically ill person, or
- a person not more than 10 years younger than the participant.

The Proposed Regulations

The new 10-year payout rule applies to all defined contribution plans and IRAs inherited in 2020 or later from an original owner. The proposed regulations provide that, depending on whether the original account owner dies before, or on or after the required beginning date for RMDs, the 10-year payout rule applies differently. For an original owner who dies before the required beginning date for RMDs, the entire interest must be withdrawn by the end of the calendar year that includes the tenth anniversary of death. For an original owner who dies on or after the required beginning date for taking RMDs, the same rule applies, but a beneficiary must also make annual withdrawals in years one through nine after the death.

Roth IRAs, which are funded with after-tax dollars, are not subject to RMDs during the owner’s lifetime. Upon the owner’s death, the RMD rules apply as though the Roth IRA owner dies before the required beginning date, and therefore an heir can wait until the calendar year that includes the tenth anniversary of death to withdraw the entire balance from a Roth IRA.

Agency Confusion Regarding 10-Year Payout Rule

In a series of revisions to Publication 590-B during 2021 and 2022, IRS provided differing interpretations of the 10-year payout rule. One interpretation is that RMDs are not required until the tenth year regardless of when the original owner died, and other is that RMDs must be made during the 10-year period if the original owner died on or after the required beginning date. In the current revision of Publication 590-B, a designated beneficiary to which the 10-year payout rule applies can wait until the tenth year after death before withdrawal of the balance, regardless of whether the original owner dies before, or on or after the required beginning date. However, the proposed regulations require a designated beneficiary to take annual withdrawals from a traditional IRA in cases where the original owner dies on or after the date that they were required to begin taking RMDs. There is resulting uncertainty with how to apply the 10-year payout rule.

The SECURE Act provisions eliminating stretch payments apply to withdrawals with respect to owners who die after 2019. The proposed regulations are proposed to apply for purposes of determining RMDs for calendar years beginning on or after January 1, 2022. Based on the proposed effective date and the interpretation of the rules in the proposed regulations, for beneficiaries who inherited traditional IRAs in 2020 or 2021, it is unclear whether not taking RMDs in respect of those years gives rise to the excise tax on undistributed amounts. IRS received comments in response to this and other issues raised by the proposed regulations in anticipation of final rulemaking. On October 7, 2022, IRS issued Notice 2022-53 in response to some of those comments.

Notice 2022-53

IRS Notice 2022-53 announced that IRS final regulations under Sec. 401(a)(9) will apply no earlier than the 2023 distribution calendar year and provides that as a result of a missed distribution of a “specified RMD,” a plan will not be treated as failing to satisfy Sec. 401(a)(9), and therefore an individual will not be subject to an excise tax under Sec. 4974. A specified RMD is defined only for purposes of Notice 2022-53 as any distribution that, as interpreted by the proposed regulations, would be required to be made under Sec. 401(a)(9) in 2021 or 2022 if that payment would be required to be made to (1) a designated beneficiary of an employee or IRA owner if the employee or owner died in 2020 or 2021 on or after their required beginning date, and the designated beneficiary was not taking payments over their lifetime, or (2) a beneficiary of an eligible designated beneficiary if the eligible designated beneficiary died in 2020 or 2021 and they were taking payments over their lifetime.

The Takeaway

New rules apply to inherited traditional IRAs on or after January 1, 2020, as a result of changes made by the SECURE Act. Previously, those who inherited an IRA could use a stretch payments strategy in which they could spread out withdrawals from the account over their lifetime. Among other things, the SECURE Act eliminated stretch payments for most beneficiaries and introduced a new 10-year payout rule for IRAs inherited in 2020 or later from an original owner who was already taking RMDs. Proposed regulations issued by IRS have further complicated this change by requiring annual withdrawals in addition to a complete withdrawal of an account balance by the end of the tenth year for certain beneficiaries. The elimination of stretch payments and requirement of annual withdrawals reduces heirs' ability to defer taxes on the inherited IRA and can significantly increase an heir's tax liability given traditional IRA withdrawals are subject to ordinary income tax rates. Additional legislative changes impacting RMDs may also be on the horizon through what is being referred to as SECURE Act 2.0.

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