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Inherited IRAs (Traditional and ROTH)

Traditional and ROTH IRAs are a great way to defer taxes on money set aside for retirement. However, there are some things you need to know when planning your estate, and when inheriting an IRA –

1. **IRA Beneficiary Forms Rule** - The beneficiary form on file with the custodian of an IRA controls both who inherits it and its ability to be stretched out.
    a. If people other than a spouse are named as heirs, they must begin taking distributions from the account by Dec. 31 of the year after inheriting, but they can draw these out over their own expected life spans, enjoying decades of income-tax-deferred growth in a traditional IRA or tax-free growth in a Roth IRA.
    b. To give your heirs maximum flexibility, name both primary and alternate individual beneficiaries–say, your spouse as primary and kids as alternates or your kids as primary and grandkids as alternates. Your primary beneficiary then has the option of "disclaiming" or turning down the account, enabling it to pass to the younger alternate.
2. **What if there's no beneficiary form is on file?** Heirs are at the mercy of the IRA custodian's default policy. Some custodians award an IRA first to a living spouse and then to the estate. Others send it straight to the estate. Few custodians will pass on an IRA directly to the kids without a beneficiary form.
3. **If the estate is named as beneficiary**, tax deferral is cut short.
    a. If it's a Roth IRA, all funds must be withdrawn within five years.
    b. For a traditional IRA the same rule applies unless the former owner was already 70 1/2–the age at which a traditional IRA owner must begin cashing out.
        i. In that case the distribution rate for the heir is based on the age of the person who died.
4. **One IRA, Multiple Beneficiaries -** split it into separate inherited IRAs. That avoids investment squabbles and allows a longer stretch-out for the younger heirs.
5. **Trustee-to-Trustee Transfers ONLY**. Normal IRAs can be moved by the individual owner within 60 days of a distribution. No so for an inherited IRA. Inherited IRAs must be moved by a trustee-to-trustee transfer.
6. **Required Minimum Distributions (RMD**) are required to begin by Dec 31st of the year an IRA (Traditional or ROTH) is inherited, based on the life expectancy of the person inheriting the IRA (unless the estate is the beneficiary, see above).

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7. **Distribution Traps –**
   a. If the late IRA owner was 70 1/2 or older, beneficiaries must make sure the owner's mandatory distribution for the year of death is withdrawn before doing anything else.
   b. When non-spouse beneficiaries take their own payouts, they should be aware of two quirks.

      i. First, if the estate paid estate tax, they may be able to take an itemized deduction to offset some IRA income.
      ii. Second, the minimum is calculated differently than for your own IRA. You take the balance on Dec. 31 of the previous year and divide it by your life expectancy listed in the IRS' "single life expectancy" table, rather than the table used by IRA owners. The next year you use the same life expectancy, minus a year. (With your own IRA, you take a new life expectancy from a table each year.)

Inheriting an IRA is not for amateurs! They come with very complex rules; and, if you don't follow them correctly, it could cost you…a LOT!

We can guide you in filling out the beneficiary forms and dealing with an IRA you've inherited.

Contact us today!