

Inheriting an IRA?

*Pay Close Attention
to IRS Rules*

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If you inherit an individual retirement account (IRA), be aware of the complex rules that govern the transfer of these accounts, especially if you're seeking to preserve the tax-deferred growth potential these assets may provide. Failing to follow the rules to the letter could prove costly.

Inheriting from your spouse

Internal Revenue Service (IRS) rules differ depending on who is inheriting the IRA and the age of the IRA account owner when they died. The most straightforward IRA inheritance involves a surviving spouse, who has three options:

1. Roll over the IRA

If you are the sole beneficiary of your spouse's IRA, you can roll the assets into an existing or new IRA account in your name and continue contributing to the account. Effective in 2020 and later, there is no age limit for making regular contributions to traditional or Roth IRAs.

It's important to note that even if your spouse was already taking required minimum distributions (RMDs) at the time of their death, you are not required to take RMDs before you reach age 73. Therefore, a rollover may be an option to consider if you are significantly younger than your spouse. However, once you turn 73, you must begin taking annual RMDs, beginning on April 1st of the year following the year you turn 73, as if the IRA had always been your own. So, if you turn 73 in 2026, your first RMD must be taken by April 1, 2027, to avoid penalties. After that, RMDs must be taken annually by December 31st.

Keep in mind, you may be subject to a 10% early withdrawal penalty on any withdrawals taken before you turn 59 ½.

2. Remain a beneficiary

Another option is to have the IRA transferred into a beneficiary IRA. In this case, both the original account owner's name and yours appear on the account. You then can begin taking RMDs in the year following your spouse's death, or, in some cases, postpone distributions until the year your spouse would have turned 73.

This alternative provides surviving spouses younger than age 59 ½ with a key advantage: Withdrawals are exempt from the normal 10% early withdrawal penalty.

3. Disclaim the IRA

If your financial situation permits, you can disclaim your interest to allow an inherited IRA to pass to your child or another younger beneficiary who may have more time to benefit from the account's potential tax-deferred growth. They will have to take RMDs, but they can be spread over a longer period due to their age and longer life expectancy.

If you choose this option, you must disclaim the assets within nine months of your spouse's death. Also, know that this decision is irrevocable, so you should discuss the option with your financial, tax, and legal advisors.

In addition to the previous three options, you can also cash out the account, either immediately, or over a period not to exceed five years. Before selecting this option, plan to meet with a tax professional to understand the tax consequences, which can be significant, depending on your age, the account size, and other factors.

Inheriting from a non-spouse

Non-spouses can also roll retirement plan account assets into an IRA in their own name or choose to transfer IRA accounts into a beneficiary IRA. A big difference, however, is that non-spouse beneficiaries must begin taking RMDs by December 31st of the year following the account owner's death. The amount of the distributions will be based on your life expectancy.

Under the SECURE Act, all distributions must be made to an eligible beneficiary within 10 years of the death of the account owner, providing the account owner died after December 31, 2019.

- If the owner died before their RMD start date, beneficiaries can take distributions any time within the 10 years.
- If the owner died on or after their RMD start date, annual RMDs are required during the 10-year period, with the balance fully distributed by the 10th year.

If you miss the initial RMD deadline, you will generally be required to withdraw the entire account value by the end of the fifth year after the original account owner's death. You typically won't face a 10% early withdrawal penalty, though you will owe ordinary income taxes on any distributions.

Eligible designated beneficiaries who are not subject to the 10-year distribution rule include:

- Surviving spouses
- Individuals not more than 10 years younger than the account owner
- Chronically ill individuals
- Disabled individuals¹
- Minor children

A non-spouse can also choose to disclaim the IRA, allowing it to pass to a younger beneficiary. The rules are the same as for spouses: The disclaimer must be made within nine months of the account owner's death, and once made, the decision is irrevocable.

Inherited Roth IRAs

Generally, inherited Roth IRA accounts are subject to the same RMD requirements as inherited traditional IRA accounts, according to the IRS. Withdrawals of contributions from an inherited Roth IRA are tax free, and withdrawals of earnings are tax free, provided the Roth account has met the 5-year holding requirement at the time of the distribution. If the original account was not open for five years, the earnings portion of distributions may be taxable until the five-year mark is reached by the beneficiary. Distributions from another Roth IRA cannot be substituted for these distributions unless the other Roth IRA was inherited from the same decedent.

We're here to help.

Given the complexity of these rules, individuals inheriting an IRA are encouraged to reach out to professional tax or financial advisors to discuss tax-smart strategies for managing account assets, based on their personal situation, circumstances, and goals.

To learn more about ways to simplify complex financial challenges and pursue the Return on Life® you and your family desire, contact the Return on Life Wealth Partners team at 440.740.0130 or visit us online.

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