

The Truth About Taxes & Retirement

WILL THE GOVERNMENT INHERIT YOUR IRA?



Provided to you by:

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What You Should Know About Inherited IRAs

WHO WILL INHERIT YOUR IRA?

Nancy saved for her retirement with hopes of having enough to cover her own living expenses and leave an inheritance for her children. She placed as much as she could into her IRA, thinking estate taxes were all her children would potentially owe upon receiving their inheritance.

When Nancy passed away, her children inherited her IRAs and cashed them out immediately. Their tax preparer informed them that they owed not only estate taxes, but also income taxes on the inheritance. The additional income took them into a higher tax bracket, resulting in a higher tax levy on the portion subject to income tax. In the end, Nancy's children were able to keep less than half of the money she anticipated they would receive.

Traditional IRA Tax Implications

Most people know that there will be taxes due upon inheritance, but what they don't realize is that one of the potentially largest tax burdens their beneficiaries may incur is the income tax due on inheritance because pre-tax money is used to fund IRAs. The entire accumulated amount (principal and interest) in a traditional IRA is fully income taxable upon distribution. So, a large inheritance may

not end up being as large as your beneficiaries had hoped. As you can see from Nancy's story, understanding the potential tax consequences of passing on any IRAs to your beneficiaries is an essential first step toward maximizing your own retirement assets and the legacy you leave for your loved ones. To follow is additional information to help get you started.

You've worked to build your retirement savings; take time to make informed decisions.





Inheritance Options For Spouses

Spouses typically have the following options available upon inheritance of an IRA:

- ››› Treat the IRA as their own and designate themselves as the account owner
- ››› Treat the IRA as their own by rolling it over into their own IRA or other qualified plan
- ››› Act as the IRA beneficiary

Spouses are the only beneficiaries who are allowed to roll an inherited IRA into their own IRA and postpone distributions until they reach age 70 ½. This could be advantageous and may mean a higher inheritance value than other forms of distribution. Just be careful of

the 10 percent early withdrawal penalty if a distribution occurs prior to age 59 ½. In many cases, spousal transfers may offer significant tax advantages. Remember, however, that you should work with a tax professional to make a decision that best suits your particular needs.

Inheritance Options for Non-Spouse Beneficiaries

The biggest difference between spousal and non-spousal IRA inheritances is that a non-spousal beneficiary cannot treat the IRA as their own and make any contributions or rollovers to the IRA. But, non-spousal beneficiaries may be able to make a trustee-to-trustee transfer to another IRA as long as the new IRA is opened and preserved in the name of the deceased IRA owner for the benefit of the non-spousal beneficiary. A big concern for non-spousal

inheritances, since they can't treat the IRAs as their own, is to make sure the required minimum distribution (RMD) is taken. You can estimate the required minimum distribution from Pub 590 on the IRS website, but it's best to seek a qualified tax professional before making any withdrawals. Of course more than the RMD may be taken out of the IRA, but these amounts are also considered taxable income and are likely to increase the income tax owed by the beneficiary.

Why It's Important to Name Your Beneficiaries

A very important initial step in helping your beneficiaries with the inheritance and distribution of your IRAs is to make sure the beneficiaries are named and on file with the IRA custodian. Be specific: individually name both the primary and contingent beneficiaries of each IRA. By naming both primary and contingent beneficiaries, the primary beneficiary has the option to disclaim the IRA and pass it down to the contingent beneficiaries. Otherwise if there are no beneficiaries on file with

the custodian, the heirs may be subject to the distribution policy of the custodian. This may pose problems as the money may not go where you intended.

Tip: Keep your beneficiary status up to date on each IRA you own. For example, if you have your children named as primary beneficiaries and all grandchildren named as contingent beneficiaries of an IRA, add additional grandchildren as new contingent beneficiaries when they are born.

NANCY'S HEIRS

What Could Have Nancy's Heirs Done to Minimize Their Taxes?

First, they shouldn't have done anything with the IRA until they spoke with a financial professional and tax and legal professional. Because an IRA is a means of deferring federal income tax, when there is a distribution from an IRA, income taxes will be due.

Second, they should have analyzed the different choices for the money. Was there an option to spread out withdrawals over time to lessen

the tax burden or did the income have to be taken as a lump sum?

Third, they should have looked at the tax consequences of withdrawing the money. Would a withdrawal put them into a higher tax bracket? Could it affect Social Security income qualification? There are many short and long-term questions that need answers before taking any money from the IRA.



THE NEXT STEPS

If you're planning to leave assets to loved ones, take the opportunity to learn from Nancy's mistakes. Below are some important next steps:

- ››› Meet with a qualified financial professional and tax and legal professional to review your qualified retirement accounts. If you have money in IRAs, find out if that's the best strategy. There may be tax-deferred investments and insurance product options that may not require your heirs to pay taxes on the accumulated earnings or interest credited.
- ››› Diligently name your IRA beneficiaries.
- ››› Educate your loved ones. Take the time to inform your spouse or children about the tax consequences of any future inheritance.

You've worked to build your retirement savings; take time to make informed decisions. Taking proactive steps today could yield thousands of dollars of difference for your loved ones tomorrow.

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