



INHERITED IRAs

A Guide to Help Beneficiaries Who Inherit an IRA in 2020 or Later



Individual Retirement Account (IRA) beneficiaries must take payments from the IRAs that they inherit based on a complex set of rules. How and how much they have to take depends, in part, on whom or what has inherited the IRA.

What You'll Find in This Guide

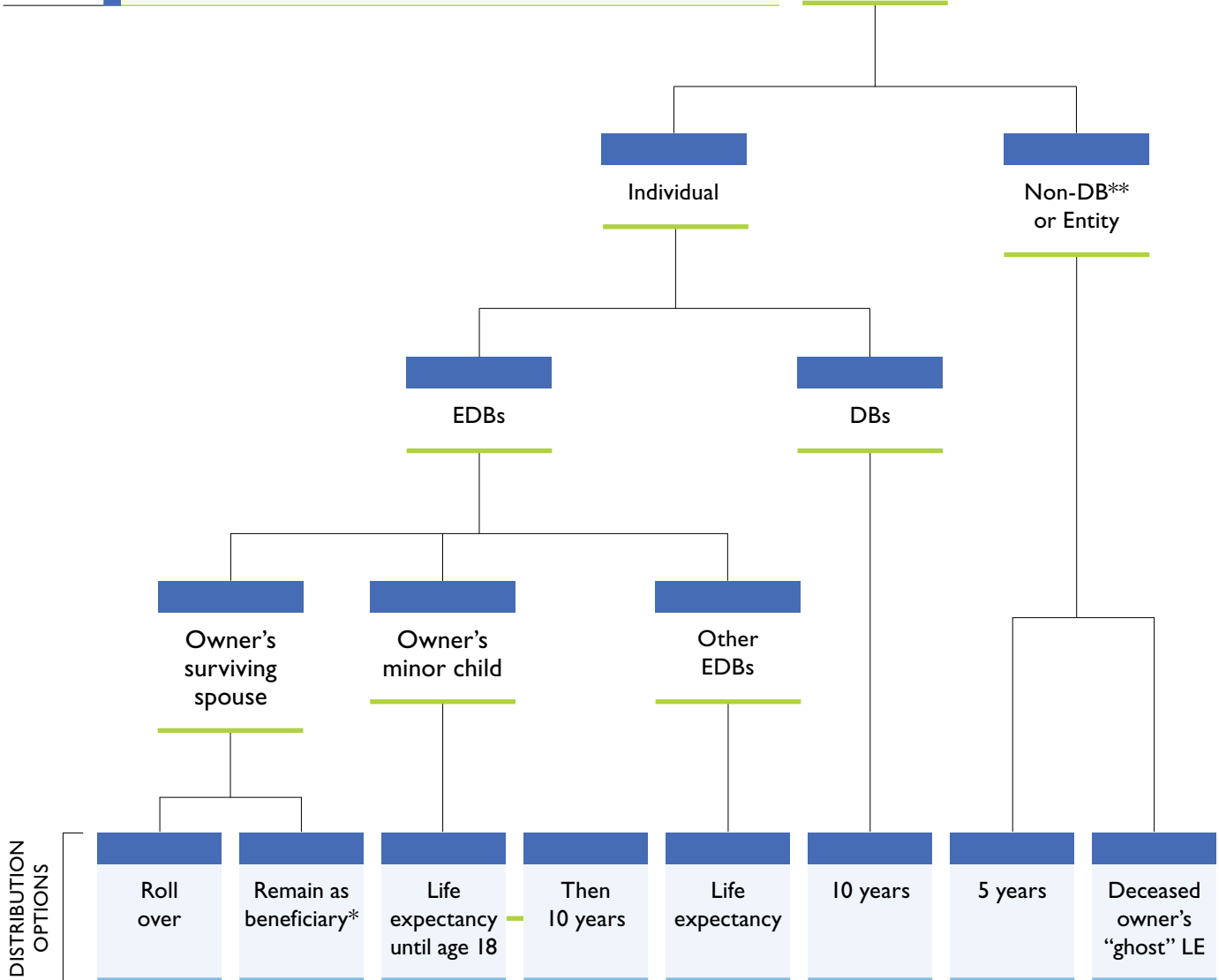
- Quick Reference Inherited IRA Chart
- Beneficiary Checklist—*Things to Consider when a Client Inherits an IRA*
- Features of an Inherited IRA
- The Rules for Inherited IRAs—*Explore the Rules for Beneficiaries*
- Successor Beneficiaries

Quick Reference Inherited IRA Chart

EDB	Eligible Designated Beneficiary
DB	Designated Beneficiary
Non-DB	Non-designated Beneficiary
LE	Life Expectancy



Beneficiary



*There are two scenarios when a surviving spouse may decide to postpone rolling over some or all of the inherited IRA to his or her own IRA:

1. To avoid the 10% early distribution penalty as an IRA owner, a surviving spouse who is younger than age 59½ may wish to remain a beneficiary on some or all of the inherited IRA until he or she reaches that age.
2. To avoid RMDs as an IRA owner, a surviving spouse who is near the RMD distribution age and has inherited an IRA from a younger spouse may wish to remain a beneficiary on some or all of the inherited IRA until the younger spouse would have reached age 72.

**For non-designated beneficiaries or entities, the five-year rule applies when the IRA owner dies before his or her required beginning date (RBD). Alternatively, the deceased IRA owner's "ghost" life expectancy becomes the distribution rule when the IRA owner dies on or after his or her RBD.

Types of Beneficiaries

The rules define three types of beneficiaries: eligible designated beneficiaries (EDBs), designated beneficiaries (DBs), and non-designated beneficiaries or entities (non-DBs).

EDBs	DBs	Entities
Spouses	Non-spousal individuals	Charities
Disabled or chronically ill	Certain trusts	Estates
Not more than 10 years younger		Certain trusts
Minor children		
Certain “see-through” trusts		

A beneficiary’s status as an EDB is determined at the time of the IRA owner’s death.

A beneficiary’s status as a DB is determined on 9/30 of the year following the year of the IRA owner’s death.

Beneficiary Checklist

Here are some items that beneficiaries may wish to consider when inheriting an IRA.

- Last Required Minimum Distribution (RMD)
 - Determine if the IRA owner’s year of death RMD, if any, was taken. If not, take it by 12/31 of that year to avoid a 50% penalty.
- EDBs (Except Surviving Spouses and Minor Children)
 - Consider taking RMDs based on life expectancy to minimize income taxes due on IRA distributions or to maximize tax-free growth on the inherited Roth IRA account balance.
- Surviving Spouses
 - Consider special planning opportunities, including:
 - Becoming the owner of some or all of the account by rolling it over to his or her own traditional or Roth IRA or retirement plan at work.
 - If younger than age 59½, remaining the beneficiary of some or all of the account to avoid the 10% penalty on early distributions. At age 59½, a rollover of any remaining balance is still possible.
 - If age 72 or older and inheriting from a spouse who died younger than age 72, remaining the beneficiary of some or all of the account to avoid (at least temporarily) RMDs on the inherited IRA. A surviving spouse is not required to take payments from an inherited IRA until 12/31 of the year that the deceased IRA owner would have reached age 72.
 - If some or all of the account is not needed, disclaiming the amount not needed so that the contingent beneficiaries can inherit. When the contingent beneficiaries are adult children, inheriting IRAs from each parent at different times provides them with two different 10-year payout periods and, perhaps, a longer distribution time frame should the surviving spouse live considerably longer.

- Minor Children
 - Be prepared to switch from life expectancy payments to the 10-year payout at age 18. Also, beware of the Kiddie Tax, where unearned income, including inherited IRAs, above an annual threshold is taxed at the parents' rather than the child's tax rates.
- Adult Children, Grandchildren, and Other Designated Beneficiaries
 - Plan your distributions according to the 10-year payout, whereby the entire inherited IRA must be distributed by 12/31 of the year that has the tenth-year anniversary of the IRA owner's death. Schedule distributions during this 10-year period in a tax-efficient manner based on current and projected future income and tax rates.
- Any Original Beneficiary
 - Name a successor beneficiary for the inherited IRA to avoid the possibility that the estate is named by default.
 - Review the inherited investments and align them based on risk tolerance.

Features of an Inherited IRA

Consolidation

If a client inherits several different retirement accounts or IRAs from the same decedent, it might make sense to consolidate all the inherited assets. Leaving assets in multiple inherited retirement accounts increases paperwork, recordkeeping responsibility, and possibly expenses.

Tax Advantages

Beneficiaries are generally required to pay income tax on the distributions they receive from their inherited IRAs. Whatever is not required and not taken remains tax-deferred or, with a Roth IRA, tax-free. Failure to take the required amount results in a penalty of 50% of what should have been taken. Managing the income tax consequences may mean taking smaller payments over a longer period of time or taking payments over a number of years.

Flexibility

Although most beneficiaries are not required to take minimum distributions each year, he or she always has the ability to take a distribution, and the additional 10% federal tax for distributions taken prior to age 59 ½ will not apply since the distributions are the result of death.

The Rules for Inherited IRAs

Distribution Methods

Inherited IRAs are distributed over a fixed period or over a life expectancy, depending on who or what is the beneficiary of the IRA.

Entities	Five-year/deceased IRA owner's "ghost" life expectancy
DBs	Ten-year
EDBs	Life expectancy
Minor child	Life expectancy until age 18, then 10-year

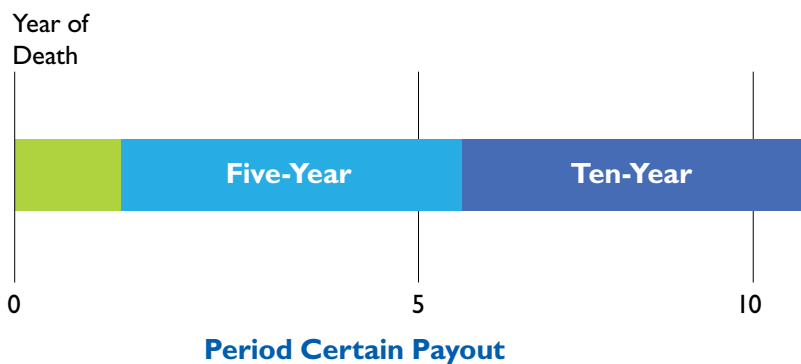
Fixed Period

Fixed period distributions require that an inherited IRA be distributed by 12/31 of the year that contains either the fifth- or tenth-year anniversary of the IRA owner's death.

Entities must use the five-year payout when the IRA owner dies before his or her required beginning date (RBD). An IRA owner's RBD is April 1 of the year after he or she reaches age 72.¹

DBs must use the 10-year payout regardless of when the IRA owner's death occurs (before, on, or after his or her RBD).

With either the five- or 10-year payout, no annual payments are required. There is only one required payment, which is the account balance on 12/31 of the deadline year. The clock begins in the year following the year the IRA owner dies, giving the beneficiary either six or 11 years over which to take payments.



Life Expectancy

Life expectancy payouts require annual minimum payments. These RMDs are determined by dividing the previous year's account balance on 12/31 by a life expectancy factor.²

$$\text{12/31 account balance} \div \text{single life expectancy factor} = \text{RMD}$$

EDBs may use the life expectancy payout regardless of when the IRA owner dies.

Most often, the life expectancy factor is based on the EDB's attained age in the year following the year the IRA owner died. The factor for all EDBs (except surviving spouses) is fixed, meaning that it is reduced by one every year after the first required distribution year. The factor for surviving spouses is recalculated, meaning that it is taken annually from the IRS table and, as a result, is reduced by less than one. Also, once a minor child reaches age 18, the life expectancy payout for the minor child switches to the 10-year payout, so that the inherited IRA must be distributed to that child in the year that he or she reaches age 28.³

¹For individuals born after June 30, 1949. Roth IRAs do not currently have an RBD for their owners.

²IRS Table I (Single Life Expectancy).

³In a recent announcement, the IRS seems to have taken the position that the age of majority for minor children is age 18 without regard to state law differences.

When the IRA owner dies on or after his or her RBD, and the beneficiary is either an entity or an EDB who is older than the IRA owner, then the deceased IRA owner's "ghost" life expectancy may be used. This "ghost" life expectancy is based on the IRA owner's attained age in the year of his or her death, reduced by one for each of the following years.

Successor Beneficiaries

An original beneficiary of an inherited IRA should name a successor beneficiary in the event he or she dies before the inherited IRA is fully distributed. If the original beneficiary is an EDB¹ and is using the life expectancy payout, then the successor beneficiary, no matter who or what, must switch to the 10-year payout. If the original beneficiary is a DB and is using the 10-year payout, then the successor beneficiary, no matter who or what, must distribute the balance of the account within the original 10-year payout (that is, by 12/31 of the year that has the tenth-year anniversary of the IRA owner's death).



¹There is a special rule for a surviving spouse who dies with an inherited IRA before the deceased IRA owner would have reached age 72.

For additional information about inherited IRAs,
contact SFG Annuity Advisors today at 800-605-4299.



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