



Kurt G. Krumholz, CFP

# Managing an IRA inheritance

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The traditional individual retirement account (IRA) has been around for a number of years, and the first generation of IRA investors are now passing away. This has left many spouses and heirs with the process of managing an IRA inheritance. Unfortunately, many are making serious mistakes along the way.

The inheritance rules for traditional IRAs are not the same as Roth IRAs. In addition, different rules apply to spouses and nonspouses (children, siblings, etc.). Here are some basic guidelines to keep in mind if you find yourself in this situation.

## Guidelines for a Spouse

For spouses, there are three options for managing this inheritance:

- Cashing in some or all of the IRA, paying the income tax at the time of the withdrawal.
- Leaving the IRA in the deceased's name.
- Rolling the IRA over into an account in your own name.

To decide which option is the best choice, surviving spouses should consider their age, the age of the IRA owner at the time of death, whether required withdrawals had already begun, income requirements, and

overall financial circumstances.

If the inheriting spouse is younger than 59½ and needs money from the IRA for household expenses, the best option is to leave the IRA in the deceased's name. The surviving spouse can then make any necessary withdrawals before age 59½ without paying a 10 percent early withdrawal penalty. Income taxes must still be paid; however, this will allow inheriting spouses to avoid the withdrawal penalty that would be imposed on an IRA rolled over into their name.

If the inheriting spouse is older than 59½, the best course of action is usually to roll the IRA over into his or her own IRA or "retitle" the inherited IRA in his or her own name. By taking this step, the benefits include the following:

- The inheriting spouse can more easily manage the funds.
- The inheriting spouse can name new beneficiaries.
- The new beneficiaries can "stretch" distributions when they inherit.

If the inheriting spouse is younger than 70½ when inheriting from a spouse older than 70½, the inheriting spouse must continue making the required minimum distribution withdrawals—which have already commenced—based on what would have been the deceased's life expectancy. However, if the inheriting spouse rolls the IRA over into a new IRA account, the

distributions can be delayed until shortly after the inheriting spouse turns 70½. Distributions will then be on the heir's life expectancy.

## Guidelines for a Nonspouse or Multiple Beneficiaries

A nonspousal heir has fewer options than an inheriting spouse. Here are examples of the most common case scenarios.

### *No Designated Beneficiary*

If the owner has already started required distributions, the heir must continue taking out distributions based on the owner's remaining single life expectancy at death. If distributions had not started, the heir must take all the money out within five years and pay ordinary income taxes. However, these withdrawals are exempt from the early withdrawal penalty, no matter how old the heir is.

### *Nonspousal Beneficiary*

If the IRA designates a nonspouse beneficiary, that person can take annual minimum withdrawals based on his or her own life expectancy regardless of whether the owner had already started required distributions. Unlike a spouse, nonspousal heirs cannot roll an inherited IRA into their own IRA. But by establishing a "beneficiary IRA"—often referred to as a stretch IRA, dynasty IRA, legacy IRA, or other names—the inherited IRA remains

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in the name of the deceased but for the benefit of the heir. A typical titling for such an IRA would read: "John Doe, deceased, IRA, for the benefit of Son Robert."

### *Multiple Nonspousal Beneficiaries*

If multiple heirs are named as beneficiaries, they may split the inherited IRA into separate IRAs. If they don't split it, the minimum withdrawals are based on the life expectancy of the oldest heir. This would not be to the benefit of the younger beneficiary or beneficiaries.

### **Work with a Qualified Professional**

Inheriting an IRA is certainly not the easiest process to manage, even for a trained financial service provider.

For example, not all IRA custodians allow all of the options discussed in this article. While the federal law does allow these options, all IRA custodians have their own guidelines. Your financial provider can help you identify other options and, if necessary, change custodians. Before you make any decisions about your IRA inheritance, consult your financial advisor. You'll be glad you did.

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