YOU INHERITED AN IRA...NOW WHAT?

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An inherited individual retirement account (IRA) is created when a beneficiary inherits an IRA, Roth IRA, or employer-sponsored retirement plan, such as a 401k, from another individual. The rules for inherited IRAs are determined by the beneficiary's classification, the type of IRA, and the original owner's age at their death.

Historically, beneficiaries inheriting an IRA or 401k could "stretch" taxable distributions over their life expectancy. In 2020, the SECURE Act made significant changes to the rules surrounding required minimum distributions (RMDs) for beneficiaries who inherit an IRA from an owner who passed away after 2019. Most notably, the new law mandates that most beneficiaries withdraw the assets from the inherited IRA or 401k within 10 years of the account holder's death.[1]

The SECURE Act categorizes beneficiaries into three categories:

1. Eligible designated beneficiaries (EDBs)
    - Surviving spouses
    - Minor children of the original account owner[2]
    - Disabled or chronically ill individuals
    - Individuals not more than 10 years younger than the deceased account holder
2. Non-eligible designated beneficiaries (NEDBs)
    - Individuals who are not classified as EDBs
3. Non-designated beneficiaries
    - Estates
    - Charities
    - Non-qualified trusts

Spousal Beneficiaries (EDBs)

Option 1: Treat as your own

A surviving spouse can treat the inherited IRA as their own and follow the same RMD rules as if they had originally set up the IRA themselves.[3]

Option 2: Inherited IRA

A surviving spouse can keep the IRA as an inherited IRA and take RMDs based on their own life expectancy.

1. The IRS has granted a grace period for 2021-2024 for beneficiaries who did not take the required distributions.
2. Once age of majority is reached, switch to the 10-year rule for the remainder of the distribution period.
3. RMDs begin at age 73 for those who reach age 73 after 2023.

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Non-eligible Designated Beneficiaries (NEDBs)

Under the new rules, the IRA must be fully distributed by the end of the 10th year following the account holder's death.[4] Although, a distinction is made between account owners who died before their required beginning date (RBD) and those who died after their RBD date.

If the account owner died after their RBD, you will need to take RMDs each year during the 10-year distributions period based on the life expectancy of the beneficiary.[5]

Inherited Roth IRAs are also subject to the 10-year rule for, but there is no income tax on withdrawals and annual distributions are not required.[6]

Non-designated Beneficiaries (e.g., Trusts, Estates, Charities)

Non-designated beneficiaries, such as estates, trusts, and charitable organizations, must distribute the entire balance of the inherited IRA within five years of the account holder's death. This distribution must occur regardless of the life expectancy of the entity.[7]

Of note, in cases where IRAs had named a trust as beneficiary, it is worth revisiting whether this still makes sense from an estate planning standpoint given the recent changes.

The above summary outlines the general rules for inherited IRAs but is not a comprehensive guide and does not cover each individual client situation. Rules for inheriting IRAs depend on factors like timing, beneficiary classification, account type, etc. For these and other reasons, each IRA owner should understand clearly how best to best determine IRA beneficiaries. Before making the decision, it's important for the owner to understand the rules and implications that apply in their specific case. Please get in touch if you'd like help exploring your options and determining the best course of action for your beneficiaries, or if you are a beneficiary and need assistance navigating the rules about your inheritance.

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4. Distributions must begin no later than 12/31 of the year in which the decedent would have turned 73 or 12/31 of the year following the death.
5. If the original account holder did not take an RMD in the year of death and were required to, an RMD must be taken from the account by 12/31 of that year.
6. There may be additional rules applied depending on whether the Roth had been a recent conversion from a traditional IRA.
7. A "see-through trust" may be eligible to take RMDs based on the life expectancy of the oldest beneficiary.