

In touch...

A newsletter for clients of the Wilson Financial Group

How Heirs Can Maximize an IRA

An IRA is a powerful vehicle to build a nest egg to fund your golden years. With years and years of tax-advantaged, compounded growth, often there will still be money in the account when the owner dies. That money, when passed to heirs, can continue to grow in an IRA without paying taxes until withdrawn, potentially for decades into the future.

Inheriting an IRA can be complicated. To make the most of inherited IRAs, it is critical that heirs understand the rules to follow when they receive the money—and the deadlines that must be met if they want to stretch the account for years to come and avoid taxes. All heirs are not the same: Spouses and nonspouses have two different sets of rules and here are the rules. If you don't list any beneficiaries or name your estate, the IRA CANNOT be stretched, and the tax shelter is lost.

IRAs pass directly to the beneficiaries and are not directed by your will. So it is critical that any changes you make to your will are reflected in the names you have on your beneficiary form. If you divorced and never updated your form to remove your ex-wife's name as the sole primary beneficiary, for instance, she will get the money at your death even if your will says the money should go to your new spouse.

When a spouse is the IRA heir

The surviving spouse can choose to take an inherited IRA as her own or remain a beneficiary. The age of the survivor makes a big difference in the choice she makes. A young widow who hasn't yet turned 59½ can tap an inherited IRA with no early withdrawal penalty as a beneficiary. She likely would want to stay a beneficiary until she hits age 59½ to be able to access that resource penalty-free; once she passes 59½ and can take her own IRA withdrawals penalty-free, she can make the inherited account her own. Once a widow takes the account as her own, she won't be subject to required minimum distributions until she turns 70 ½. If the account she is left is a Roth, taking it as her own means no RMD's for her.

Most widows and widowers who are past that early-penalty hurdle will want to take the money as their own, particularly if the IRA is a Roth. Besides potentially delaying required distributions from a traditional IRA, taking the money as their own will result in smaller required distributions.

When A Nonspouse is an IRA Heir

As designated beneficiaries, non-spouses can stretch the inherited IRA over their own lifetimes, but only if they carefully follow a number of rules. First, a nonspouse beneficiary must rename the account to include both the beneficiary's name and the decedent's name, clearly identifying who's who. For example, the account could be retitled to "Mary Smith (deceased March 1, 2018) for the benefit of Joe Smith."

A nonspouse heir can't roll the money into his own account nor can he convert inherited traditional IRA money to a Roth IRA. If you want your nonspouse heirs to have Roth money, you must convert the accounts before you die. The heir is stuck with whatever IRA you've left them.

Second, to stretch an IRA over the nonspouse beneficiary's lifetime, required minimum distributions must be taken by December 31 each year, starting in the year after the original owner dies. The beneficiaries won't pay an early-withdrawal penalty on the distributions. They will pay income tax on RMDs from inherited traditional IRAs, while RMDs from inherited Roth IRAs will be tax-free.

And that's a key point that Roth heirs will find costly if they overlook it: While Roth IRA owners aren't required to take distributions, nonspouse beneficiaries of inherited Roth IRAs do have RMDs if they want to stretch out the account. If an heir misses that inherited Roth RMD, he will be subject to a 50% penalty on the amount that should have been taken out, and he could blow up the potential for decades of tax-free income.

If multiple nonspouse beneficiaries are named, each beneficiary can stretch her distributions over her own lifetime—but only if the account is split. The inherited IRA must be split by December 31 of the year following the year the owner died. Each beneficiary retitles her share of the IRA and can then stretch out distributions over her lifetime. By splitting the inherited account, each beneficiary can also name her own successor beneficiaries. And each can choose her own investment strategy.

Monday, June 4, 2018

Social Security Workshop

Vestavia Hills Library, 6:30 - 7:30 pm

Monday, June 11, 2018

Social Security Workshop

NEW Pelham Library, 6 - 7 pm

Thursday, June 14, 2018

Social Security Workshop

NEW Pelham Library, 11am - 12 noon

Monday, June 18, 2018

Social Security Workshop

Trussville Civic Center Fireside Room 1, 11 am and 6 pm

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