

What to know when you inherit an IRA

When you inherit an IRA, you will have many planning and distribution considerations. This guide includes information on Inherited Traditional IRAs (death after 2019 and before 2020), Spousal Inherited IRAs, Inherited Roth IRAs, Successor Inherited IRAs, and other options.

Tax considerations

No matter your age or type of Inherited IRA, you will avoid the IRS 10% additional tax for premature or pre-59½ distributions on taxable amounts taken from the IRA you inherited. Depending on the type of Inherited IRA, it is important to understand if regular income taxes will be owed on distributions.

The IRS may penalize a missed RMD amount by up to 25%. This penalty can be lowered to 10% if timely corrected (generally, within two years after the year of the missed RMD). Contact your tax advisor for more information.

Distributions from Inherited Traditional IRA

Income tax will apply to taxable amounts when distributions are taken from an Inherited Traditional IRA. Larger dollar amounts can quickly put you into a higher tax bracket, whereas taking smaller distributions over time can help avoid a significant tax bill. Contact your tax advisor for more information.

Three categories of beneficiaries

Non-Designated Beneficiary (NDB)	Designated Beneficiary (DB)	Eligible Designated Beneficiary (EDB)
• Estate • Non-qualified trust • Charity (owner)	• Non-spouse individuals more than 10 years younger than IRA owner • Non-spouse individuals who are not disabled or chronically ill • Primary beneficiary of qualified “look-through” trust who is not an EDB • Minor who is not the child of the IRA owner	• Surviving spouse • Individuals not more than 10 years younger, the same age as, or older than IRA owner • Disabled or chronically ill individuals • Primary beneficiary of qualified “look-through” trust who is an EDB • Child of the IRA owner who has not reached age 21

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Beneficiary distribution options when an IRA holder dies after 2019

The following tables summarize the options you have, in an Inherited IRA, depending on if the IRA owner died before or on or after their required beginning date (RBD), generally April 1 following the year they turn required minimum distribution (RMD) age. RMD age is generally the year the IRA owner turned age 73 (if born after 1950), 72 (if born between 7/1/1949 and 12/31/1950), or 70 ½ (born before 7/1/1949).

If a beneficiary category has multiple distribution options, the beneficiary may choose which option they want to use. This election generally must be made by the end of the first year following the original IRA owner's death. The beneficiary does not need to notify the IRS of their chosen distribution method.

Beneficiary category — Individual	Life expectancy	10-year rule	10-year rule with RMDs	
Designated beneficiary:				
Non-spouse more than 10 years younger than IRA owner, not chronically ill or disabled, or minor not IRA owner’s child	n/a	n/a	n/a	
- Original IRA owner dies before RBD		X		
- Original IRA owner dies on or after RBD			X	
Eligible designated beneficiary:				
Spouse (if not claimed as own IRA)				
- Original IRA owner dies before RBD	X	X		
- Original IRA owner dies on or after RBD	X		X	
Disabled or chronically ill individuals				
- Original IRA owner dies before RBD	X	X		
- Original IRA owner dies on or after RBD	X		X	
Individuals not more than 10 years younger, the same age as, or older than IRA owner				
- Original IRA owner dies before RBD	X	X		
- Original IRA owner dies on or after RBD	X		X	
Child of the IRA owner who has not reached age 21. ¹				
- Original IRA owner dies before RBD	X			
- Original IRA owner dies on or after RBD	X		X	
Beneficiary category - Entity	Life expectancy	5-year rule	10-year rule	10-year rule with RMDs
Non-Designated beneficiary:				
Non-Qualified Trust or Estate or Charity owner’s child	n/a		n/a	n/a
- Original IRA owner dies before RBD		X		
- Original IRA owner dies on or after RBD	X ²			
Designated beneficiary:				
Primary beneficiary of qualified trust ³ is a DB				
- Original IRA owner dies before RBD			X	
- Original IRA owner dies on or after RBD				X
Eligible Designated beneficiary:				
Primary beneficiary of qualified trust ³ is an EDB	n/a		n/a	n/a
- Original IRA owner dies before RBD	X		X	n/a
- Original IRA owner dies on or after RBD	X			X

Source: Wells Fargo Investment Institute.

¹Child may take annual RMDs until age 21 (if choosing not to start 10-Year Rule right away). Then, if they are not chronically ill or disabled as defined in the SECURE Act of 2019, they are subject to the 10-Year Rule. The account balance must be distributed by 12/31 of the 10th year after reaching age 21 (age 31).

²RMDs based on owner's age in year of death, divisor reduced by one each subsequent year.

³The type of qualified trust (e.g. conduit or accumulation) and who the original trust beneficiary is makes a difference in how long the Inherited IRA for the trust can remain open. It also depends on if the trust that inherited the IRA has one or more than one beneficiary. Please note WFA does not interpret the trust and the trustee should seek competent advice to determine their exact distribution options based on their situation.

Designated beneficiary (DB)

These beneficiaries are subject to the 10-Year Rule.

10-Year Rule —The Traditional Inherited IRA must be emptied by the 10th year following the year of the IRA owner's death. If the IRA owner died on or after their RBD, the DB must take RMDs based on the DB's life expectancy during the 10-year period. If the IRA owner died before their RBD, then no distributions are required before the 10th year. Depending on the size of the account, you may want to spread distributions over the 10- year period to spread tax liability, even if no RMDs are required.

Eligible designated beneficiary (EDB)

This category has the most favorable distribution options. Beneficiaries can choose between the 10-Year Rule (with or without RMDs) and taking distributions from their Inherited IRA based on their own life expectancies. The life expectancy option is often referred to as the stretch IRA strategy.⁴

Minor children of the IRA owner can choose between taking RMDs until they reach age 21 or starting a 10-Year Rule right away. If choosing to take RMDs until age 21, they will be subject to the 10-Year Rule starting at age 21 until age 31. Regardless of whether the original IRA owner died before or after their RBD, since the child was taking annual RMDs, this 10-Year Rule will also include annual RMDs.

Non-designated beneficiary

This category includes estates, charities, and non-qualified trusts. If the owner died on or after their RBD, RMDs are based on the IRA owner's age in year of death, divisor reduced by one each subsequent year. If the owner died before their RBD, the 5-year rule is followed (no RMDs).

5-Year Rule — Empty the Inherited IRA by December 31 of the year containing the fifth anniversary of the owner's death.

Inherited IRA distribution options when an IRA owner died before 2020

Life expectancy: Applies to Inherited Traditional and Inherited Roth IRAs. You will take annual RMDs without a 10-Year Rule. RMDs are based on your life expectancy using a divisor from the IRS Single Life Table and the prior year-end IRA value, on a term-certain basis (formula shown after this section). Qualified trusts use the age of the oldest trust beneficiary.

Non-spouse RMD Formula (Term-Certain)

$$\frac{\text{Prior Year-End Value}}{\left(\begin{array}{l} \text{Single Life Table divisor} \\ \text{for attained age in year} \\ \text{following IRA owner's year} \\ \text{of death} \end{array} \begin{array}{l} \text{—} \\ \text{1 for each} \\ \text{subsequent year} \end{array} \right)} = \text{RMD}$$

Spouse beneficiary:

Surviving spouses have the option to claim the Inherited IRA as their own IRA **or** to open an Inherited IRA and be treated as an EDB.

⁴Stretching an IRA simply refers to the ability to take RMDs over the beneficiary's single life expectancy (using the term-certain calculation method) rather than over the life expectancy of the original IRA owner.

Establishing an Inherited IRA when you are under age 59½ allows you to avoid the 10% additional tax on pre-59½ distributions that you might have if the assets were taken from your own IRA. You always have the ability to transfer the Inherited IRA to your own IRA, even if you have been taking distributions.

RMDs from the Inherited IRA will start:

- The year your deceased spouse would have reached RMD age, or
- The year following your spouse's death, if your spouse died on or after their RBD.

Annual RMD calculations are based on your life expectancy using a divisor from the IRS Single Life Table, the prior year-end IRA value and utilizes the recalculation method. The recalculation method uses a new divisor from the table each year:

Spouse RMD Formula

$$\frac{\text{Prior Year-End Value}}{\text{Single Life Table Divisor}} = \text{RMD}$$

Rollover/Transfer to own IRA — Only a spouse can roll over or transfer the funds into an IRA in his/her own name. An IRA keeps the funds in a tax-advantaged account and defers income taxes, if due, until distributions are taken.

If claimed as own IRA, the distribution rules will use the Uniform Table and apply based on the surviving spouse's age — meaning no RMDs from their Traditional IRA until he/she reaches RMD age and no RMDs from their Roth IRA.

Distributions from Inherited Roth IRAs

Inherited Roth IRAs use slightly different rules than Inherited Traditional IRAs.

For deaths in 2020 or later, the 10-Year Rule for Inherited Roth IRAs does not include RMDs (regardless of whether the original IRA owner had reached their RBD or not). EDBs can choose between the 10-Year Rule and life expectancy.

For deaths before 2020, beneficiaries take RMDs based on their life expectancy.

Spouse beneficiaries can claim the Inherited Roth IRA as their own Roth IRA or open an Inherited Roth IRA and be treated as an EDB.

Whether you will take a lump-sum distribution, disclaim, or open an Inherited IRA, you should understand the two types of Roth IRA distributions: **qualified** and **non-qualified**.

- **Qualified distributions** from an Inherited Roth IRA are tax-free. Distributions are qualified if the original owner of the Roth IRA died after the account had been funded for 5 years or more.
- **Non-qualified distributions** from Inherited Roth IRAs may be subject to tax, but not the 10% additional tax. When the Roth IRA owner died before the account had been funded for five years or more, distributions are **non-qualified**. The five-year clock will continue in the Inherited IRA and until that fifth year has been reached, the Roth ordering rules for distribution are followed: As long as your distributions are equal to or less than the total amount the IRA owner contributed and/or converted, you have no taxes due. Any earnings distributed before the account has been open for five years or more will be taxable.

Beneficiary Category - Successor	10-year rule	10-year rule with RMDs	Remaining years of 10-year rule	Remaining years of 10-Year Rule with RMDs ⁵
Original Beneficiary - EDB	n/a	n/a	n/a	
- Original IRA owner dies before RBD	X			
- Original IRA owner dies on or after		X		
Original Beneficiary - DB	n/a	n/a	n/a	
- Original IRA owner dies before RBD			X	
- Original IRA owner dies on or after RBD				X

Source: Wells Fargo Investment Institute.

⁵ RMDs based on original beneficiary's age and date of death of the original IRA owner.

Successor beneficiary of an EDB: If you inherit an Inherited IRA from an EDB, you are a “Successor” beneficiary and will have a “Double Inherited IRA” using the 10-Year Rule.

If the **original** owner died on or after their RBD, you must take RMDs² based on the **EDB's** life expectancy on a term-certain basis during the 10-Year Rule. If the EDB had started a 10-Year Rule, the successor beneficiary will continue that same 10-Year Rule. If no 10-Year Rule had been started, the successor will begin a new 10-Year Rule.

If the **original** owner died before their RBD, then the successor of the EDB will typically continue the 10-Year Rule based on the original owner's death without annual RMDs. However, if the EDB was already taking RMDs based on their single life expectancy, then the successor will have annual RMDs based on the **EDB's** life expectancy and will need to deplete the IRA by the end of the 10-Year Rule.

Successor beneficiary of a DB: If you inherit an Inherited IRA from a DB, you are a “successor” beneficiary and will have a “Double Inherited IRA” also using the 10-Year Rule

If the DB dies before the end of the 10th year and the account is still funded, you will have the remaining years of the DB's 10-Year Rule to empty the Inherited IRA. If the owner died on or after their RBD, you must take RMDs based on the **DB's** life expectancy on a term-certain basis during the remaining years of the 10-Year Rule.

If the **original** owner died before their RBD, then the successor of the DB will typically continue the 10-Year Rule based on the original owner's death without RMDs. However, if the DB was already taking RMDs based on their single life expectancy, then the successor will have annual RMDs based on the **DB's** single life expectancy and will need to deplete the IRA by the end of the 10-Year Rule.

Other options

These distributions choices are available to most beneficiaries.

- **Disclaimer:** If you do not need or want the assets, you can disclaim, or refuse, all or a portion of the assets within nine months after the IRA owner's death. The person who disclaims is considered to have predeceased the IRA owner and cannot dictate who will inherit the assets. The assets will pass to a beneficiary as selected on the beneficiary designation form.

The IRA default beneficiaries may be used if there are no valid beneficiaries on file:

1. Surviving spouse
2. Surviving children (as defined under state law)
3. IRA holder's estate

- **Lump-sum:** This strategy will exhaust the entire account in one distribution, with retirement assets losing their tax-advantaged status. Taxes will be due on the taxable portion of the distribution in the year received and may place you in a higher tax bracket. Once a non-spouse beneficiary chooses to take a lump-sum distribution, it cannot be undone.

60-day rollovers are not allowed for Inherited IRAs unless you are the spouse. In this situation, a spouse beneficiary would have 60 days to roll over the inherited assets into their own IRA, if they meet the roll over requirements.

Review your choices

Wells Fargo Advisors understands your desire to maximize the benefits you can receive from your IRA inheritance. Please investigate all the options you have in regard to these assets with your tax and legal advisors before enacting a strategy. We look forward to helping you and your family with your financial goals and objectives.

Wells Fargo Advisors does not provide tax or legal advice, investors need to consult with their own tax and legal advisors before taking any action that may have tax or legal consequences.

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