

The Ultimate IRA Strategy

"Do you want your IRA account to live beyond YOU, Your Spouse and even live beyond your Children?"

If you answered NO, then read no further.

Is the answer YES? Then continue to read to unlock the ultimate IRA strategy for making your money last for generations and generations!

You have an IRA and are you concerned how taxes can erode your IRA account drastically? The first step is to choose your beneficiary wisely.

When choosing beneficiaries for your IRA, there are really only two things you need to know:

1. Your will is not the proper place to name an IRA beneficiary, and
2. To the extent that it's practical to do so, it can be advantageous to name your younger loved ones as the beneficiaries to your IRA.

Where to Name an IRA Beneficiary

When you open an IRA, the IRA custodian will ask you to fill out a beneficiary form. When you die, the person(s) listed on that form will inherit your IRA — **even if somebody else is designated in your will as the recipient of your IRA.**

So, when something changes in your life — new children, new grandchildren, divorce, etc. — it's important to update your IRA beneficiaries accordingly. One of your children being left out (or an *ex*-spouse inheriting your IRA!) simply because you forgot to update a piece of paperwork would be a real shame.

So how does a beneficiary choice affect the taxability? Here we go.....

Beneficiary Distributions: "Stretching" an IRA

When a non-spouse beneficiary inherits an IRA, she's required to take distributions from the account over her remaining life expectancy. The younger the beneficiary, the greater her remaining life expectancy and, therefore, the greater the ability for savings via tax deferral.

For example, if a 25-year-old inherits an IRA (from somebody other than his spouse), he'll have to start taking distributions the following year (at age 26). At 26, according to the IRS life expectancy tables, his remaining life expectancy is 57.2 years. As such, he'll be required to distribute the IRA over the next 57.2 years.

In contrast, if a 78-year-old inherits an IRA (from somebody other than his spouse), he'll have to distribute the account over the next 10.8 years — a much shorter period due to his shorter remaining life expectancy.

In short, the longer a beneficiary's remaining life expectancy, the smaller percentage of the IRA he has to withdraw each year, and the more he can take advantage of the power of tax deferral. As a result, to the extent practical, it often makes sense to choose your *younger* loved ones as the beneficiaries for your IRA.

Easy, Right?

As complicated as IRAs can be, choosing the beneficiary (or beneficiaries) for your IRA is fairly straightforward. Just remember to keep your beneficiary form up to date *with your IRA custodian*. And, if it's reasonable to do so, consider leaving your IRA to your younger loved ones in order to maximize its value for your family.

Inherited IRA: Spouse Beneficiary

As a spouse beneficiary, you have two primary options:

1. Do a spousal rollover — rolling the account into your own IRA, or
2. Continue to own the account as a beneficiary.

Note: There's no deadline on a spousal rollover. Should you want to, you can own the account as a beneficiary for several years, then elect to do a spousal rollover.

If you do a spousal rollover, from that point forward, it will be as if the IRA was yours to begin with. All the normal IRA rules will apply — whether [Roth](#) or [traditional](#).

If you continue to own the account as a beneficiary, the rules will be mostly the same, with a few important exceptions.

Here is a tax savings planning point!

No 10% Penalty

First, you can take distributions from the account without being subject to the 10% penalty, regardless of your age. So if you expect to need the money prior to age 59^{1/2}, this is a good reason *not* to go the spousal rollover route — at least not yet. (As mentioned above, there's no deadline on a spousal rollover.)

Withdrawals from Inherited Roth IRA

Second, if the inherited account was a Roth IRA, any withdrawals of earnings taken prior to the point at which the *original* owner would have

satisfied [the 5-year rule](#) will be subject to income tax (though not the 10% penalty).

Spouse Beneficiary RMDs

Third, if the inherited account was a traditional IRA, you'll have to start taking Required Minimum Distributions in the year in which the deceased account owner would have been required to take them, rather than the year in which *you* would ordinarily be required to take them. At that point, however, the distributions will be calculated the same as if it were your own account. (That is, each year, the RMD will be based on your own remaining life expectancy.)

Note: If the original owner (your spouse) was required to take an RMD in the year in which he died, but he had not yet taken it, you're required to take it for him — calculated in the same way it would be if he were still alive.

Inherited IRA: Non-Spouse Beneficiary

When you inherit an IRA as a non-spouse beneficiary, the account works much like a typical IRA, with three important exceptions.

No 10% Penalty

Distributions from the account are *not* subject to the 10% penalty, regardless of your age. (This is the same as for a spouse beneficiary.)

Withdrawals from Inherited Roth IRA

If the inherited account was a Roth IRA, any withdrawals of earnings taken prior to the point at which the *original* owner would have satisfied [the 5-year rule](#) will be subject to income tax, though not the 10% penalty. (This is also the same as for a spouse beneficiary.)

Non-Spouse Beneficiary RMDs

Each year, beginning in the year after the death of the account owner, you'll have to take a Required Minimum Distribution from the account. The idea is to distribute the balance of the account over your remaining life expectancy. The actual calculations are best explained with an example.

Imagine that your grandfather passes away in 2010, leaving you his entire IRA. If he was required to take an RMD in 2010 but he had not yet taken one, you'll be required to take his RMD for him — calculated in the same way it would be if he were still alive.

Beginning in 2011, however, RMDs from the account will be based on *your* life expectancy. On your birthday in 2011, you turn 30 years old. According to the [IRS Life Expectancy Tables](#), your remaining life expectancy at age 30 is

53.3 years. As a result, your RMD for 2011 will be equal to the account balance as of 12/31/2010, divided by 53.3.

For 2012, your RMD will be equal to the account balance at the end of 2011, divided by 52.3. In 2013, it'll be the end of 2012 balance, divided by 51.3.

Put in simple terms - Your IRA lasts a lot longer!

Important exception: If you want, you can elect to distribute the account over 5 years rather than over your remaining life expectancy. If you elect to do that, you can take the distributions however you'd like over those five years — for example, no distributions in years 1-3 and everything in year 4.

Successor Beneficiary RMDs

If the original non-spouse beneficiary dies before the account has been fully distributed, the *new* inheriting beneficiary is known as a successor beneficiary.

Successor beneficiaries are subject to the same rules as the original beneficiary, with one exception: The successor beneficiary must continue to take distributions each year as if they were the original beneficiary.

By way of illustration, in the example above, if you had died in 2013, leaving the entire IRA to your sister, she would be required to continue taking RMDs from the account according to the exact same schedule you had been taking them, regardless of her own age. So if you hadn't yet taken your 2013 distribution, she'd have to take it. Her 2014 distribution would be exactly what yours would have been if you were still alive: the 12/31/2013 balance, divided by 50.3.

Tips for Non-Spouse Beneficiaries

- When you retitle the account, be sure to include both your name *and* the name of the original owner.
- Name new beneficiaries for the account ASAP.
- If you decide to move the account to another custodian (to Vanguard from Edward Jones, for instance), do a *direct transfer only*. If you attempt to execute a regular rollover and you end up in possession of the funds, it will count as if you'd distributed the entire account.

Tax trap to beware of.....

Inherited IRA: Multiple Beneficiaries

If multiple beneficiaries inherit an IRA, they're each treated as if they were non-spouse beneficiaries, and they each have to use the life expectancy of the *oldest* beneficiary when calculating RMDs. This is *not* a good thing, as it means less ability to "stretch" the IRA.

However, if the beneficiaries split the IRA into separate inherited IRAs by the end of the year following the year of the original owner's death, then each beneficiary gets to treat his own inherited portion as if he were the sole beneficiary of an IRA of that size. This *is* a good thing, because it means that:

- A spouse beneficiary will be treated as a spouse beneficiary rather than as a non-spouse beneficiary (thereby allowing for more distribution options), and
- Each non-spouse beneficiary will get to use his or her own life expectancy for calculating RMDs.

To split an inherited IRA into separate inherited IRAs:

- Create a separate account for each beneficiary, titled to include *both* the name of the deceased owner as well as the beneficiary.
- Use direct, trustee-to-trustee transfers to move the assets from the original IRA to each of the separate inherited IRA accounts.
- Change the SSN on each account to be that of the applicable beneficiary.

A Few Last Words

When you inherit an IRA, you absolutely *must* take the time to learn the applicable rules before you do anything. Don't move the money at all until you understand what's going on, because simple administrative mistakes (attempting a rollover rather than a trustee-to-trustee transfer, for instance) can be *very* costly.

Also, should you elect to get help with the decision — not a bad idea, in my opinion — don't assume that somebody knows the specifics of inherited IRA rules just because he or she is a financial advisor. In these circumstances, I'd suggest looking for someone with CPA certification.

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